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UNIVERSITY OF PENNSYLVANIA

FIRE LOSS ADJUSTMENT PROBLEMS IN THE UNITED STATES

OSCAR S. NELSON

A THESIS

IN ECONOMICS

PRESENTED TO THE FACULTY OF THE GRADUATE SCHOOL IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF DOCTOR OF PHILOSOPHY

CHESTER, PA.

1930

with the Compliments of
Oscar S. Nelson

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TO

MY WIFE

R. UNIV.
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LEIDEN

PREFACE

Fire loss adjustment problems in the United States have probably existed since the first insured fire loss occurred. The problems today are not the same as when the fire insurance business was first organized, for the adjustment problems change with changing insurance practices, laws, and business conditions. As an example of this; when fire insurance was first written there was a very close relationship between the insured and the high officials of the company. Both parties to the contract knew exactly what property was covered and its condition and value. There was very little opportunity for disagreement as to the amount payable in the event of a loss. Furthermore, the moral character of the insured was known at the time the rate was set and the insurance written, as well as at the time the adjustment was negotiated.

From a very modest beginning, the business of fire insurance has grown tremendously. It is no longer possible for the company officials to deal directly with the insured. The business is now transacted through the medium of various specialized representatives. Rates are set, insurance is written and adjustments are made by different agencies, and the insured seldom if ever comes into contact with the owners or directors of the company. As a result of the changes in the methods of conducting the business of insurance and the growth and increasing specialization of industry, fire loss adjustment at present is faced by many serious problems. Efforts have been made to solve these problems as they arose, but there is still a great deal of room for improvement in the adjustment situation.

The present fire loss adjustment problems are considered from the standpoint of (1) the insurer and available adjustment agencies, (2) the property and insurance coverage, and (3) the insured and adjustment service. The question of loss adjustment from the point of view of underwriters is taken up in the second and third chapters. The second chapter deals with the

evolution of adjustment methods of fire insurance companies. It shows the causes underlying each important change in the adjustment machinery. The third chapter outlines the present agencies and personnel used in effecting settlements with claimants. The importance of each agency is shown, and the character of the personnel available is considered. In this chapter also, the subject of public fire loss adjusters is discussed. Since public fire loss adjusters normally represent claimants, it would seem that this topic logically should be considered along with that of the insured in the last chapter. However, Public Adjusters are subject to regulation by public authority, as are all adjusters in certain states. No clear line of distinction is drawn by the various state laws between public, company and independent adjusters. Furthermore, public adjusters are a part of the machinery that bridges the gap between the insurer and the insured and are required to have qualifications comparable with those of company and independent adjusters. Therefore, to treat public adjusters in a separate chapter would involve unnecessary repetition. In the fourth and fifth chapters, the question of the property and insurance coverage is treated. Chapter four deals with the economic and Chapter five with the legal aspects of property valuation. The subject of the insured and adjustment service is treated in the sixth chapter.

The author is indebted to adjusters and insurance officials in all sections of the country for their generous response to requests for information. He wishes to acknowledge also his indebtedness to Dr. S. S. Huebner, Dr. C. K. Knight, Dr. H. I. Lowman, Dr. C. A. Kulp, Professors of Insurance, and Dr. E. L. McKenna, Assistant Professor of Insurance, at the University of Pennsylvania; to Mr. C. W. Mowry, Manager, Inspection Department, Associated Factory Mutual Fire Insurance Companies, and to Mr. Prentiss B. Reed, General Adjuster, The Phoenix Assurance Co., Ltd., all of whom read the manuscript and offered many valuable criticisms and suggestions.

Philadelphia, Pa., June, 1930. O. S. NELSON.

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CHAPTER I.

INTRODUCTION

The Nature and Importance of Fire Loss Adjustment

If the possibility of a fire loss did not exist, there would be no justification for the business of fire insurance. Proper fire loss adjustments therefore, must be an important consideration at the time a contract is entered into. The service that is being sold at the time the policy is issued is the fire loss settlement which may or may not become necessary. Protection against the financial consequences of the destruction of property by fire is afforded by a fire policy. An adjustment is necessary to determine the value of the wealth destroyed, so that restitution of an equivalent amount may be made.

What Is Fire Loss Adjustment?

In his book on "The Economic Theory of Risk and Insurance", Allan H. Willett has chosen to define Fire Insurance as follows:

> "that social device for making accumulations to meet uncertain losses of capital through fire, which is carried out through the transfer of the risks of many individuals to one person or a group of persons".[1]

This definition gives fire insurance a social implication. Fire loss adjustment, which is the equitable fulfillment of the policy conditions must, therefore, have its social as well as economic implications. The function of fire insurance is not carried out until the funds collected from the many have been disbursed to the few who suffer fire loss. From a social or economic point of view the disbursement of the insurance funds to the few is very important. The improper payment of funds in settlement of fire loss claims may in time tend to undermine the social structure by making it profitable to be careless or dishonest.

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[1] Allan H. Willett, "The Economic Theory of Risk and Insurance", Macmillan Co., New York, 1901, p. 106.

Fire loss adjustment may be defined along the lines laid down by Mr. Willett in his definition of Fire Insurance above. It is the method, or procedure, of using the accumulations of the many to indemnify the few for loss of capital resulting from fire.[1] Of course, it must be remembered that the payment of losses is only one phase of the use of the funds collected. The reduction of the possibility of loss of capital through fire by fire prevention work and proper underwriting is equally important, and funds are required for this purpose. The questions of fire prevention and proper underwriting are closely tied up with the adjustment of fire losses.

A Social as Well as a Valuation Problem.

It is assumed by some that the risks of the many are known and, therefore, that the aggregate of risks assumed by the underwriters is known. Nothing could be further from the truth. The risks are in most cases very roughly estimated at the time of their transfer. Except in the case of the more important properties, very little attempt is made to check the statements of the insured regarding the value of the risk assumed by the underwriters. Consequently, when the event insured against actually occurs, the capital value that must be restored out of the premium accumulations from the many is not known. A further difficulty arises because the proportion of the value destroyed must in turn be determined. If these were the only difficulties in adjusting fire losses, the task might not be considered out of the ordinary. In actually achieving a settlement, however, the inconsistencies, variations and uncertainties in human behavior must be dealt with. Not only the insured, but also the adjuster, is a human being. Values, indemnities and satisfactions are subjective concepts. Opinions of individuals differ widely. Emotions play an important role. It is difficult to apply generalizations to specific cases.

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[1] E. R. Hardy, History and Principles of Fire Insurance, Library, Insurance Society of New York, 1927, p. 6, defines loss adjustment as follows:

"The determining of the just amount payable by insurers to an insured person under his policy when loss occurs."

There are really three parties to every fire insurance contract: the insured, the underwriter, and the public at large. The rights, obligations and interests of each of the three should enter every loss settlement. However, it is too idealistic to conceive of a fire loss settlement in which none of these rights, obligations or interests are violated. Loss adjustment is a practical problem, which is, however, best arranged by means of correct principles.

The fire insurance contract provides for the payment of an amount equal to the "actual cash value" of the property destroyed. This amount, however, does not in all cases constitute complete indemnity. The insured will not be in the same position as he was in prior to the fire until he has become readjusted mentally as well as economically. The payment of cash by the insurance company is not sufficient. The companies have for many years employed adjusters to facilitate the evaluation of the loss, and also to aid in rehabilitating claimants financially. The service rendered by the adjuster is a part of the indemnity contemplated in the policy, although not required by its terms. The various services rendered by adjusters are enumerated in Chapter VI.

Importance of Loss Adjustment.

The subject of fire loss adjustments is important because of its economic and social implications. The United States suffers an annual fire loss of over $500,000,000.[1] Stock fire insurance companies are called upon to pay out annually over $300,000,000[2] and Mutual Companies over $100,000,000[3] in the settlement of fire loss claims. During 1928 alone $73,091,625,404[4] in fire

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[1] Proceedings, The National Board of Fire Underwriters, New York City, 1928, p. 156.

[2] Fire Insurance By States from 1900 to 1920, The Weekly Underwriter, New York, 1929, p. 126.

[3] Estimated in 1928, 1440 Mutual Insurance Companies reported losses of $69,013,566.66. This figure includes some windstorm and hail losses. However, there are about 2500 Mutual Fire Insurance Companies in the United States, and so, total losses of all companies exceeds the above amount. Harry P. Cooper, Mutual Insurance Bulletin, The National Association of Mutual Insurance Companies, Indianapolis, Indiana, 1929, p. 16.

[4] Fire Insurance by States, Op. Cit.

risks were written by stock companies and over $25,000,000,000[1] by mutual companies. If it is assumed that each risk is insured up to 80%, the value of all property insured each year in the United States amounts to over $125,000,000,000, perhaps $150,000,000,000. To carry this vast total of fire risks the stock companies collect annually over $670,000,000[2] and the mutual companies over $200,000,000[3] in premiums. The collection and disbursement of such vast sums of money annually is of vital concern to society. Great harm may come from the improper settlement of fire loss claims.

Furthermore, fires cause physical and mental crises in the lives of the individuals at interest and result in abnormal behavior on their part. Society is concerned with the type of adjuster employed to meet these crises and to aid the victims to readjust themselves mentally as well as economically. The importance of fire adjustments cannot be overstressed for the number of individuals involved in fire losses annually is very large. In 1920 the Actuarial Bureau Committee of the National Board of Fire underwriters reported that they, "have names of approximately three and one-half million persons who have been concerned with loss by fire since January 1915."[4] Assuming an equal distribution from year to year, at least 700,000 people are concerned with loss by fire annually.

The Relation of Underwriting to Loss Adjustment

The various phases of the fire insurance business are interdependent. Underwriting service cannot be rendered the insured without considering the amount of premium paid. Rates may not be set without studying the fire hazard in the light of past experience. Similarly, a certain degree of uniformity and stability of adjustment practices must be assumed when rates are set and insurance is written. Payments made in the settlement of fire loss claims must bear some relation to premiums collected.

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[1] Estimated at 33⅓% of that of Stock Cos.
[2] Fire Insurance by States, Op. Cit.
[3] Harry P. Cooper, Op. Cit., p. 15.
[4] Proceedings, The National Board of Fire Underwriters, New York, 1920, p. 64.

Whenever rates are reduced too drastically or losses become excessive, companies find it difficult to operate at a profit.[1]

Fire Prevention and Moral Hazard.

In order to place the adjustment of losses on a proper basis, control over risks insured must be rigidly exercised. Fire prevention work is undertaken by insurance companies with the objects of reducing the physical hazard and eliminating fires due to carelessness. If losses can be reduced to those resulting from fires of purely accidental origin, fire insurance can be limited to the performance of its true function. It was never intended that insurance should give protection against gross carelessness or fraud.

When the business of fire insurance was first started, underwriters came directly into contact with the owners of the properties insured. It was then possible to exclude risks in which gross carelessness or dishonesty on the part of the owner might increase the hazard. Under these conditions, at least, a higher rate could be quoted to compensate for the additional risk. At present, however, it is not possible to give as much attention to rates on individual properties. Standardization of rates has been a necessary outgrowth of modern business. Furthermore, it is not always possible to exclude risks which may be undesirable because of possible carelessness or moral laxity on the part of the owner or custodian of the property. Discrimination is not permitted by law. The owner of property does not wish to be denied protection, because of the fact that he is not personally in charge of the property. A large percentage of the property insured is mortgaged or otherwise financed. Those extending their credit in this way must have insurance protection. Lastly, some brokers require insurance companies to take their poor risks as a precedent to receiving their good risks. For these reasons, risks must be standardized, and adjustments must be for the most part standardized. This is done by actively undertaking to prevent fires by eliminating carelessness in the construction and care of

[1] E. R. Hardy, The Making of the Fire Insurance Rate, The Spectator Company, New York, 1926, p. 94.

property and by reducing the moral hazard through the use of arson squads and special investigators.

Rate Setting and Adjustment Policy.

Payments made in the settlement of fire loss claims must come out of the premium income of the company. Changes in adjustment methods must result eventually either in a change in the premium rate or in operating results. When rates are fixed, it must be assumed that no drastic changes in adjustment policy will be made. In 1927, for example, the United States Bureau of Efficiency made a survey of the insurance situation in the District of Columbia.[1] It concluded that fire insurance rates were too high and should be materially reduced. Accordingly, a substantial reduction in fire insurance premium rates effective January 1, 1929, was made by the Underwriters' Association of the District of Columbia. When the Bureau made its investigation of premium rates, it also studied the adjustment situation and made several recommendations. The purpose of the investigation into adjustment practices was to prevent the companies from offsetting the reduction in premium rates by alterating their methods of adjustment. The bureau concluded that, if steps were taken to see that persons adjusting loss claims were competent and of good character, policyholders would be protected, and any change in adjustment policy would have to be for the better. It was a definite conclusion of the bureau that control of premium rates must be supplemented by control of the settlement of claims in order to be effective.

Loss Adjustment and Business Policy.

Closely connected with the standardization of loss adjustment methods is the question of Business Policy. Should a liberal attitude be taken in the settlement of individual loss claims, or should all losses be adjusted on a technical and uniform basis? Since individuality has been eliminated from rate-setting and underwriting, should it also be eliminated from loss adjustment? The popular view is always in favor of individuality and liber-

[1] Report on the Department of Insurance of the District of Columbia, October 23, 1927, United States Bureau of Efficiency, Washington, D. C.

ality in loss settlement. Experience has shown, however, that both are productive of abuses.[1] If all risks were standardized at a high level by eliminating gross carelessness and the moral hazard, liberality could be practiced and claims handled on an individual basis. Since risks have not been wholly standardized, and, since the elements of gross carelessness and design must still be added to that of accident, in considering the hazards insured against, a certain degree of uniformity in adjustment methods must be enforced. At least those losses which result from gross carelessness or design must be adjusted on a strict business mode, enforced by cooperation on the part of all interested companies. Only the highest type of risks should be settled on the basis of a liberal policy, if any at all.

The Problems Involved

The problems of fire loss adjustment will be discussed from three points of view, namely: their historical development, their present status and their solution. It is possible to classify the problems of fire loss adjustment under three heads, namely, the adjustment machinery, the valuation of the property covered by the policy contract, and the settlement with the insured. In the succeeding chapters the problems are discussed in this order.

First will be considered those problems relating to the machinery available for effecting settlement between the insured and the insurer. This machinery has undergone a long period of evolution, caused and conditioned by changing business methods, the business policies of individual companies, and the attitude of the general public. An important consideration in connection with the machinery of loss adjustment is the human element involved in the adjuster, whose personality means more to the adjustment of a fire loss than perhaps any other single element. He must have the fundamental qualifications of patience, "stick-to-it-iveness", stability of temperament, an agreeable personality adaptable to people in all stations of life and under varying conditions, extreme tact and genuine sympathy. As one prominent adjuster

[1] Cornelius Walford, The Insurance Cyclopaedia, The Spectator Co., Chicago, 1874, Vol. III, p. 517.

has expressed it, " there is no profession that calls for such varied qualifications as does that of an adjuster; he must be a student and a good judge of human nature; he must have the disposition and training of a detective; he must have diplomacy; he must be possessed of patience, and have some ability and knowledge of the various lines of business with which he comes in contact." [1]

The second group of problems concerns the determination of the "actual cash value" of the property destroyed. The amount payable must be determined under circumstances involving complete or partial obliteration of the property insured, inaccurate or incomplete books and records, the handling salvage and the question of repair or replacement. A lack of uniformity in the statute laws and court decisions in various sections of the country further complicates these problems. Adjusters are governed to some extent by laws and court decisions, since the courts may be resorted to by claimants if adjustments are not satisfactory. The interpretation and application of Policy provisions involves a thorough understanding of previous practice in this respect.

The final group of problems relates to the insured. First it is necessary to study the factors influencing his behavior at the time of a fire and his attitude toward the company and the adjuster. The behavior and attitude of the insured condition and determine the procedure to be followed. It is also necessary to discuss the tactics of adjusters, the types of claimants and the psychology of loss adjustment. In the last analysis, much depends upon the skill and ability of the one charged with the responsibility of actually negotiating the settlement. The various services rendered the insured at the time his loss is adjusted also are enumerated.

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[1] Wilson, C. F., Wilson Adjustment Company, Denver, Colorado, letter July 28, 1929.

CHAPTER II.

EVOLUTION OF LOSS ADJUSTMENT METHODS

Early Adjustment Practices to 1900

The adjustment of losses has always been an important branch of the fire insurance business, but its importance has become more and more recognized with the growth in wealth and the increase in the density of population. When fire insurance was a local matter, and a common knowledge regarding the nature and value of all property insured was held, it was a comparatively easy matter to determine the indemnity in case of a fire loss. As wealth has increased, and the population has become denser, the inspection of risks and the adjustment of losses has become more and more a problem for experts. At present, the most serious problems in loss adjustment are met in the wealthiest and most congested sections of the country.

Losses Adjusted by Officers and Directors.

When the fire insurance business was first organized in the United States, all matters of importance were handled by officers of the companies.[1] Very few policies were written, and the territory covered was small. Whenever a loss occurred, it was the duty of a high official to negotiate the settlement of the claim. The losses incurred by the Aetna in the great fire of 1835 in New York were adjusted by its President, Mr. Brace.[2] Since the directors and other high officials of the companies personally solicited the business, set the rates and adjusted the losses, there was little opportunity for misunderstanding between the insured and the insurer. However, problems of adjustment no doubt arose, because of competition among the various companies. During the formative stages of fire insurance, competition in rates

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[1] F. C. Oviatt, Historical Study of Fire Insurance in the United States, Annals of the American Academy of Political and Social Science, Philadelphia, 1905, Vol. XXVI, No. 2 p. 161.

[2] Ibid, p. 162.

was especially prevalent.[1] The policy of loss adjustment was indirectly affected. This competition in rates was, of course, inevitable, because of the inexperience of underwriters in measuring fire hazards. Nevertheless, it was manifested in a tendency toward liberality in loss payments on the part of some companies, and created an adjustment problem that all had to face.[2] Furthermore, bad risks and doubtful customers gave rise to other difficulties in the settlement of claims. However, in the early part of the nineteenth century the fire insurance business in the United States was controlled by a few large companies. For a third of a century this control was by direct writing.[3] These companies worked together harmoniously and by means of oral agreements were able to maintain a high standard of underwriting and adjusting. The function of loss adjustment was for the most part in the hands of important company officials during this period. When serious losses occurred, the Secretary or President normally took charge of settlements as late as 1860.[4]

The Agency System and Loss Adjustment.

The growth of the agency system led to changes in the methods of settling losses. The rapid growth of wealth and population in the United States and the advantages of a wide distribution of risks, led to the development of the agency system. It became impossible for company officials to supervise personally all transactions. The insured now came in contact only with the agent, and the company became an impersonal entity. The possibilities of misunderstandings increased. The Phoenix Fire Office of London (1804), the Insurance Company of North America (1807), the Eagle Fire Company of New York (1810), and the Hartford Fire Insurance Company (1810) were the first

[1] F. G. Smith, Practical Remarks on the Present State of Fire Insurance business: The evils of Competition Pointed Out, with Hints for Improvement, 1832, quoted by Cornelius Walford, The Insurance Cyclopædia, The Spectator Company, Chicago, 1874, Vol. III, p. 559.

[2] F. G. Smith, Op. Cit., p. 559.

[3] H. C. Brearley, Fifty Years of a Civilizing Force, Frederick A. Stokes Co., N. Y., 1916, p. 256-7.

[4] S. R. Weed, Former and Present Day Methods of Adjustment, The Fire Insurance Contract, The New York Insurance Society, 1920, p. 568-70.

to appoint agents in the United States.[1] These agents at first received certain fees charged the policyholders for surveying the risks.[2] They were authorized to solicit insurance, determine premiums and issue policies.[3] The officers and directors made numerous trips to develop business, appoint agents and adjust losses.[3] The agency system developed slowly at first, and by 1854 only 27 of the 65 New York Companies employed agents.[4] Even the larger companies were local, confining their business to single states. Between 1850 and 1885 the agency system developed rapidly, due in part to the new practice of paying Commissions.[5]

The expansion thus made possible enabled fire companies to distribute their risks over wide areas, but it also brought with it numerous problems of underwriting and loss adjustment. It was no longer possible for officials or directors to visit properties without great difficulty. The company no longer controlled its own business, and became subject to outside pressure, even in the settlement of claims.[6] The companies soon found it necessary to cooperate in an attempt to regulate premiums, commissions and adjustments.[7] An important step toward correcting the evils of the agency system was the employment of special agents or field men to supervise business that could not be conveniently reached by employees of the home office.[8] At first, these special agents spent most of their time in adjusting losses. Later, attention was devoted also to the work of inspecting risks and authorizing rates. The Protection Fire Insurance Company of Hartford was the first to develop the agency system on a large scale, especially in the middle west, and it also took the lead in the employment of special agents.[9] In 1853, J. B. Bennett pre-

[1] H. C. Brearley, Op. Cit. p. 233-4.
[2] H. C. Brearley, Op. Cit. p. 235 and 237.
[3] Ibid, p. 237.
[4] F. C. Oviatt, Op. Cit., p. 161.
[5] Ibid, p. 245.
[6] Ibid, p. 245 and 246.
[7] Ibid.
[8] F. C. Oviatt, Op. Cit., p. 167.
[9] Ibid, p. 168.

pared the first blank proofs of loss ever used. This form, in its essential features, has not been changed since.[1]

It is not easy now to realize the conditions under which the special agents worked. They travelled extensively and appointed agents, inspected towns and settled losses.[2] They made many mistakes because of lack of cooperation, but they were pioneers, especially in the field of adjusting losses. They had to contend with problems arising out of competition in rates, the growing power of agents and the rapidly changing industrial conditions.

Effect of Brokerage System on Loss Adjustment.

About 1840, the broker began to find a place in fire insurance affairs. Like the agent, he soon became an economic necessity in the development of the business. The use of the brokerage system tended to widen the gap between the insurer and the insured, and had an important effect on the adjustment of losses. There was a great deal of opposition on the part of the old established companies, but the ability of the broker to get business decided the issue.[3] New companies were rapidly organized during the forties and fifties, and competition for business became keen.[4] Rates were cut, and high commissions were paid to obtain business. The objections raised against the brokerage system were as follows:[5]

1. The broker is not necessary, since every property owner is within easy reach of an insurance office.

2. The broker serves the insured as well as the insurer.

3. In his anxiety to place a risk and earn a commission, the broker often conceals or misrepresents material facts regarding the risk and renders the policy void.

4. It is impossible for the insurer to determine the moral character of the insured.

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[1] Ibid, p. 169 and 171.

[2] Ibid, p. 169 and 171.

[3] H. C. Brearley, Op. Cit., p. 251 and 257. (The passage of the general insurance incorporation law in New York in 1849 made it much easier to secure a charter and led to a rapid influx of new companies, many insufficiently financed, and promoted by inexperienced men.)

[4] Ibid, p. 257.

[5] Ibid, p. 253, 256 and 259.

5. The broker does not hesitate to place insurance with irresponsible and unstable companies paying high commissions.

6. The paying of commissions has a direct tendency to divert business from its proper channels and to introduce unreliable men between the insurer and the insured.

7. The cost of insurance is greatly increased.

8. Ruinous competition has resulted. Companies try to outbid each other by paying from 10% to 20% of premiums as commissions. Discredit, suspicion and prejudice have been brought upon the insurance interests of the country by these practices.

In spite of all opposition, however, the brokerage system has prospered. By 1862, brokers were so numerous that they were able to form the New York Board of Insurance Brokers.[1] The broker was now able to bargain with companies and to dictate terms.[2] A complaint was made that some brokers habitually required companies to take undesirable risks along with desirable ones.[3] Underwriters could no longer use the same degree of discretion in the selection of risks. The brokerage system as well as the agency system has come to stay, regardless of its effect on underwriting and loss adjustment.

While the payment of commissions has given rise to numerous problems, it has been responsible for the tremendous expansion of insurance service at a time when the growing industry and commerce of the United States has most needed it. The practice of paying commissions to secure fire insurance business should not, therefore, be too hastily condemned. The agent and the broker have been awake to the needs of business, and have sold insurance protection to property owners who would never have been reached by the conservative methods in vogue at the beginning of the century. The new problems brought to the insurance business, however, have to be met and if possible solved. It has become necessary for the companies to strive for more cooperation. This cooperation was brought about in a number of ways.

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[1] H. C. Brearley, Op. Cit., p. 254.
[2] Ibid, p. 258.
[3] Ibid, p. 254.

Loss Adjustment by the Special Agent.

Following the close of the Civil War, a period of more active cooperation began. Conditions at the time were very unsatisfactory.[1] Business was in a demoralized condition. There had been an alarming increase in fire losses. The increase in "moral hazard" was becoming a serious menace. Companies were weakened by competition and were facing ruin. The National Board of Fire Underwriters was organized in 1866 for the purpose of bringing about cooperation among companies in matters of common interest. Premiums, commissions and losses were given first attention.[2] Cooperation in other matters came later. The local agents of the companies were given more and more power in the writing of insurance. In 1867, a new departure placed the responsibility for writing and issuing the policy entirely with the agent.[3] Because of this change in policy, it was deemed advisable to keep more closely in touch with the local representative, and the special agent was required to devote more of his time to supersivion and less to adjusting.[4]

As has already been stated, the chief work of the outdoor solicitor or inspector was to settle losses. No regular adjusters were known. In case of a serious loss, the home office was notified and the secretary or president took charge of the adjustment.[5] In spite of the many other duties of the special agent, he occasionally rendered effective adjustment work. Builders and merchandise experts were sometimes employed to assist in appraising losses. If several inspectors or officials appeared on the ground at the same time, one of them would usually be designated to do the work. This plan continued through the sixties. The adjustment of losses, was, however, considered a necessary evil, which interfered with the regular work of the men in the field. Selling insurance was considered of prime importance, and adjusting was slighted.

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[1] Ibid, p. 4 and 12.
[2] H. C. Brearley, Op. Cit. p. 13.
[3] F. C. Oviatt, Op. Cit., p. 170.
[4] Ibid, p. 172.
[5] S. R. Weed, Op. Cit., p. 568-70.

The Meeting System.

The socalled "Meeting System" of adjusting losses was originally used because of the steadily decreasing percentage of risks insured by one policy alone, and the handling of joint adjustments was a growing problem. The increasing property values and a multiplicity of policies on the same risk made necessary the eventual trend toward consolidation of adjustments, so that one or two, rather than five, ten or even twenty adjusters could handle a given individual loss.[1] Under the former method of adjusting losses, expense accounts were overloaded, the loss ratio of the various companies was increased, the business of fire insurance was discredited with the public and the skill of most of the competent adjusters available was wasted.[2] Two or three average adjusters usually are better able to settle a loss satisfactorily than fifteen or twenty first class ones. It was difficult for adjusters to exercise the rights of the companies under the policies without becoming obnoxious to the client. It became impractical to permit each adjuster to examine the property, to take the damaged property at the estimated value, to exercise the rights of replacement, appraisal and subrogation and to examine all books and records. United action was necessary.

At the time of the Chicago fire in 1871, the new plan was used for the first time. In principle it involved the organization of the adjusters assigned to a given fire and the selection of a committee to adjust it.[3] The company representatives sent to adjust the losses resulting from the Chicago conflagration organized a clearing house system to avoid duplication of effort. There was some friction and delay in settling those losses, but on the whole they were promptly handled, and the plan seemed quite satisfactory. The integrity of those taking part in settling these losses has never been questioned. Subsequently it became quite customary for the representatives of the companies interested in a given fire to

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[1] Harrington, George, Asst. Sec., Comm. on Losses and Adjustments, New York Board of Fire Underwriters, letter Feb. 4, 1920.

[2] Willis O. Robb, Op. Cit., p. 18.

[3] Ibid, p. 568-70.

meet and select a committee to adjust the loss. The meeting system was superior to any method previously used.

There were objections to it, however, and certain abuses were allowed to creep in which soon led it into bad repute. It was seldom that a committee was unanimous in its decision, and often the results were quite unsatisfactory to the companies interested. The custom arose of paying for the services of the adjusters on a given loss out of the proceeds of the sale of salvaged property. Naturally, there was very little check on the amount collected, and it soon became evident that certain favored adjusters were getting rich. Brokers too, were linked up with the assignment of committees to losses. Unnecessary friction, useless delay and high costs of settlements stirred up opposition to the plan. The practice of levying assessments on the companies for the compensation of adjusters or of deducting them from the proceeds of salvage was difficult to eradicate. The meeting system remained quite prevalent in the settlement of large losses until the beginning of the twentieth century. While successful at first, it proved to be defective in that it hindered prompt action, required frequent communication with interested companies, did not permit the common collection of adjustment results and data, and resulted in lack of authority and permanency of adjustment machinery in a given locality.[1]

The purpose of the foregoing discussion has been to trace the development of problems of fire loss adjustment. These problems have for the most part been an outgrowth of changing business conditions and methods. Competition in rates very early affected adjustments by causing an increase in "moral hazard." As long as the insured took the aggressive in the insuring of property, and a few large companies controlled the business, a high quality was maintained. Competition for business and especially rate cutting resulted in a lowering of standards and a tendency toward liberality in loss settlements. With the advent of the agency system and later of the brokerage system of securing business, the insurer and insured became more and more sep-

[1] Ibid, p. 19.

arated. The close personal contact, which at first obtained, was lost. Risks were not scrutinized with the same carefulness, because a new motive for insuring property, that of earning a commission, was introduced. The insured also was not as ready to understand the point of view of the underwriter. While these changes in the insurance business influenced indirectly the adjustment of losses, the employment of special agents instead of officers and directors to settle losses affected adjustments directly. The officers and directors were more experienced in insurance matters and had a more personal interest in the insured as well as in the company. Furthermore, the influence of brokers in settling claims became more potent, and avenues for personal gain were opened to the adjuster, the special agent. The breach between the insured and the company was now complete. All phases of the business were in the hands of representatives. Because of the new adjustment conditions, it soon became necessary to secure more cooperation among the various companies, in the settlement of losses. More uniformity in adjustment practices seemed necessary. Conditions were improved a great deal by cooperation in the fixing of premiums and commissions. Ruinous competition had been checked by the National Board and other organizations. However, many unsatisfactory conditions still existed in the loss end of the business.

Early Cooperation in Loss Adjustment

The history of fire insurance in the United States suggests the conclusion that companies are more likely to cooperate when threatened with adversity.[1] The heavy losses of the Chicago and Boston conflagrations in 1871 and 1872 respectively, were responsible for a greater degree of cooperation in loss adjustments than had previously been known.[2] As noted above, the meeting system of handling losses was an outgrowth of these catastrophes. This was the beginning of a period of cooperation which was to last well into the twentieth century.

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[1] H. C. Brearley, Op. Cit., p. 36.
[2] Ibid, p. 28 and 32.

Staff Adjusters and Salvage Companies.

Following the Chicago fire, some companies in New York organized loss departments, while others employed certain preferred independent adjusters.[1] The Chicago fire taught them the need for skilled adjusters, and cooperation in loss settlements. Little progress was made for some time. It was difficult to secure competent men, and companies were deceived by the adjusters employed. Opportunity for graft, especially in connection with salvage operations, was inimical to loyal service. Systematic cooperation in handling losses was very slow to develop, and the organization of a salvage company seemed to be a necessary prerequisite to cooperation in adjustments. About 1879 the first salvage companies were organized in New York to handle merchandise. These original companies were not owned or controlled by insurance companies; nevertheless, they rendered valuable service for a time and conditions were bettered. The evil in connection with the handling of salvage was not completely eliminated, however, until the insurance companies created their own cooperative salvage organization, which is still in existence.[2]

The Establishment of Adjustment Bureaus.

Up to the beginning of the twentieth century, very little progress had been made toward cooperation in the adjustment of fire losses. As has been noted, the companies each sent representatives to take care of their interests in the settlement of claims and much duplication of effort resulted. The state or special agents were given many duties besides the work of adjusting losses. In the more densely populated sections of the country, Staff adjusters were later employed to specialize in the settlement of claims. In the sparsely settled districts, it was often difficult to find even a special agent near enough to a loss to adjust it. The problem of securing competent men to adjust losses was partly solved by the appearance of independent adjusters, who

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[1] Weed, S. R., Op. Cit.

[2] The Insurance Almanac, Op. Cit. 1929, p.

stationed themselves at strategic points throughout the country. The problem of duplication of effort was met in part by the adoption of the meeting system, but, as has been shown, this did not prove entirely satisfactory. There was a growing need for specialized men, independent of the producing end of the business, who could represent all companies on any given loss, and who could act promptly and with authority.

This need for cooperation in loss adjustment, therefore, was twofold. It was uneconomical for each insurance company to send an adjuster on a claim and the increasing size and complexity of the insurance business as well as the tendency toward specialization in all lines of endeavor, made necessary the employment of men skilled in adjustment work. The great majority of the special agents had had no specific training in adjusting losses. Furthermore, permanent adjustment organizations were necessary to collect loss information for common use and to provide permanent representation of underwriting interests as a whole.

The first company adjustment bureau on record was organized in 1875.[1] It was called the "Insurance Adjustment Company of Cincinnati" and was formed by twenty-two stock and five mutual fire insurance companies doing business in Cincinnati at the time. The idea of a company adjustment bureau seems to have originated with the Secretary of the Amazon Insurance Company. Thus the germ of the modern adjustment bureau was started, but this venture ceased operations about 1886. Before the end of the nineteenth century, however, the Insurance Adjustment Company of Cincinnati and the Western Adjustment and Inspection Company of Chicago (discussed below) had done something toward the reduction of the expense of loss adjustment and the broadening of the service of adjustment, already being rendered in certain localities by independent adjusters.[2] But defects similar to those discussed above still existed.

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[1] Weed, S. R., Op. Cit.
[2] Robb, Willis O., Op. Cit., p. 19.

Adjustment Bureaus in the Middle-West

The Western Adjustment and Inspection Company is perhaps the oldest company owned adjustment organization still functioning. It was established in 1885[1] and operates in the states of Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin. In 1919, a similar corporation, the Underwriters Adjusting Company was organized to settle losses in the same territory.[2] It is questionable whether two such organizations can operate in the same district without friction. In 1926, Mr. Bartow, a member of the National Board of Fire Underwriters, in discussing the situation, said:[3]

"....how can we justify two adjustment bureaus in the western field, operated by two groups of companies, each competing with the other for the privilege of making adjustments? If a loss occurs each races to the scene of the fire, to be the first on the ground and adjust the loss before the other. In our western office we sometimes get a proof of loss thirty days after the fire for a substantial amount, and that is the first notice we ever have of that loss. The story is, the agent notified the adjuster.....We all know there are two factions in the West acting in regard to some subjects, but surely this is a broad enough subject to be taken out of factional interests".

The Western Adjustment and Inspection Company adjusts about 50% of all losses in its territory.[4] All classes of losses are handled by both the Western Adjustment and Inspection Company and the Underwriters' Adjusting Company. The latter company, operating in practically the same territory as the former, adjusts about 25% of all fire loss claims. Salaried staff adjusters of individual fire insurance companies settle about 5% of all losses, usually those in which they alone are concerned. Another 10% of losses in the middle western territory are adjusted by in-

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[1] Insurance Almanac, The Weekly Underwriter, New York, 1929 p. 541.
[2] Insurance Almanac, Op. Cit., 1929, p. 534.
[3] Mr. Bartow, Proceedings of the National Board of Fire Underwriters, Op. Cit., 1926, p. 77.
[4] Harding, I. C., Pres., Western Adjustment and Inspection Company, Chicago, letter, Sept. 14, 1929.

dependent adjusters, who handle all classes of claims. Brokers and local agents of companies adjust about 8% of all losses, usually small claims. Since brokers and local agents settle small claims almost exclusively, and, since the estimate of 8% is by value, it is evident that a large number of adjustments are controlled by selling agencies in this territory. The adjustment situation in the Middle West is not satisfactory, in view of the above facts. The company owned adjustment bureaus are competent enough to handle claims in a satisfactory manner provided a more centralized control with cooperation among all companies is maintained.

In the Chicago territory, the Cook County Loss Adjustment Bureau has superseded the Western Adjustment and Inspection Company, and the Underwriters Adjusting Company in the placing and supervising of adjustments. It uses the services of both organizations in effecting adjustments, however. The Cook County Loss Adjustment Bureau adjusts losses on a plan similar to that of the New York Committee on Losses and Adjustments. (Discussed below). It was organized November, 1925,[1] and handles all proofs of loss, regardless of who adjusts the losses. Adjusters or anyone interested may go to the Bureau for a further check. The equitable arrangement of indemnities was assisted by the organization of the Cook County Adjustment Bureau, and the success of the Bureau is due mainly to the fact that each company has cooperated by relinquishing its own discretion and has permitted the automatic assignment of losses.[2]

Committee on Losses and Adjustments, New York Board of Fire Underwriters.

In 1901 the New York Board of Fire Underwriters created a Committee on Losses and Adjustments to handle losses in the New York Metropolitan area.[3] This action was the result of the growing dissatisfaction with previous methods of adjusting

[1] Insurance Almanac, Op. Cit., 1928, p. 495.
[2] Proceedings of the National Board of Fire Underwriters, Op. Cit., 1929, p. 88.
[3] Weed, S. R., Op. Cit.

losses.[1] The rules adopted at the time of organization are with minor modifications still in force. The executive functions of the committee are in charge of a secretary and a staff of assistants. The formation of this committee has been a big step in the direction of a more scientific adjustment of losses. The cost of adjusting losses has been reduced, and suspicion of graft in salvage operations has been eliminated through cooperation with the salvage company. The success of the committee plan has been apparent from the first, and, up to the present, no better system for adjusting losses has been evolved. The committee operates over a small territory, but one containing more insurable value than perhaps any other similar area. The Committee takes charge of adjusting losses in Greater New York City and Hudson County, New Jersey, north of the Hackensack River, or in other words, the metropolitan area surrounding the New York harbor.[2] In this territory the Loss Committee takes primary jurisdiction over all ordinary losses where more than three insurance companies are interested. In the case of sprinkler leakage losses, only two companies need be interested in order to give the Committee jurisdiction. In addition the Committee has jurisdiction over all warehouse losses, all fur losses, all fraudulent losses and all losses that are particularly suspicious. However, any member of the New York Board, upon written notice, may choose to handle its interest in any loss in its own way with the limitation that only approved adjusters may be employed.

The New York Committee does not employ salaried adjusters but makes use of the seventy odd independent and company staff adjusters, available in the district. These men are paid on a per hour or per diem and not on a fee basis. The committee pays the bills of adjusters and experts and then apportions the cost among interested companies. In selecting adjusters for a given fire, the Loss Committee of the New York Board generally follows the wishes of the company having the largest line of insur-

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[1] Robb, Willis O., Op. Cit., p. 19.

[2] Harrington, George, Ass't. Sec'y., Committee on Losses and Adjustments, New York Board of Fire Underwriters, New York, letter, July 1929.

ance, each company interested in the loss sending in its choice of adjusters as soon as the fire loss is reported. But the Loss Committee has authority to choose adjusters according to their fitness and availability. The number of adjusters assigned to a loss depends upon its size, importance, the number of distinct classes of property involved and other similar considerations.[1] While the fact that a staff of salaried adjusters is not continuously employed seems to be a weakness in the system, it is argued by those familiar with the situation that it would be difficult to have a properly balanced staff if the adjusters were on a salary basis.

The New York system of adjusting losses is different from that in any other part of the country and seems to have met with a large degree of success. Some of the success of the New York Committee system, however, is due to the small area over which it operates and the propinquity of the risks. During the course of any adjustment, frequent conferences of the adjusters involved may be held in the office of the secretary. Before taking certain steps, such as repairing and rebuilding, handling salvage, etc., the approval of the secretary must be obtained.[2] The adjusters also have access to the information regarding previous fires, which is on file in the main office, and are able to supplement their knowledge and skill by appeal to the secretary. Such close supervision of loss adjustment is not possible in more widely settled districts. An elaborate system of records, indexes and statistical data is maintained for the use of adjusters. Close relations are also maintained with other bureaus of the New York Board, and with outside organizations.

The method followed by the Committee of the New York Board assures uniform adjustment of all losses in which several companies are interested, provided some companies do not choose to act independently. In any case approved adjusters must be used, and surprisingly few losses occur in which there is justification for one company to act independently of the others interested. In the case of losses not handled by the New York Board Com-

[1] Robb, Willis O., Op. Cit., p. 20.
[2] Robb, Willis O., Op. Cit., p. 20.

mittee, about 40% of the total, salaried staff adjusters of individual companies and independent adjusters are employed.[1] While the independence of action maintained by some companies and the supervision of some loss adjustments by individual company adjustment departments introduces a certain lack of uniformity in adjustment practices, the situation is much better than it used to be. There is one respect in which the adjustment situation in New York City is particularly gratifying. Practically no adjusting is done by brokers or agents who are interested in the selling end of the business. New York underwriters seem to have profited by their experience of a few years back in this regard.[2] In another and very important respect, the system followed in New York City is superior to that of other company adjustment bureaus. The adjusters employed to settle losses are of a higher type and are better qualified to adjust losses accurately and promptly. The use that is made of independent adjusters properly supervised is no doubt responsible for this situation. However, other adjustment bureaus could maintain the same high standard of ability by paying higher salaries, and so attract the best men from the independent field. The Loss Committee of the New York Board does not secure a higher type of adjuster without paying him well. It should be added that the cost of adjusting losses is higher in New York City than in other sections of the country.[3]

The concrete benefits resulting from the operation of the committee on losses and adjustments of the New York Board may be summarized as follows:[4]

1. A sharp reduction in actual cost of adjusting losses.
2. A reduction in the volume of losses adjusted.
3. A more creditable and dignified attitude toward the public.
4. A reduction in fraud and corrupt practices.

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[1] Harrington, George, Op. Cit.
[2] See Chapt. III, discussion of Public Adjusters.
[3] Proceedings of the National Board of Fire Underwriters, Op. Cit., 1929, p. 95.
[4] Robb, Willis O., Op. Cit., p. 22.

5. A central source of statistical and historical data and authoritative opinion on loss and adjustment matters.

6. An increase in the responsibility and efficiency of adjusters.

7. A greater degree of control and influence over adjustments by individual companies.

8. A greater degree of uniformity in adjustment practice.

The General Adjustment Bureau.

The success of the Committee on Losses and Adjustments of the New York Board of Fire Underwriters has led to the formation of other company adjustment bureaus. In the East, the General Adjustment Bureau was formed in 1905.[1] The automatic assignment of losses, which feature has in large measure been responsible for the success of the New York Committee plan, has not been adopted by the companies who are members of the General Adjustment Bureau for losses occuring within its territory. It has, therefore, been necessary for it to compete with independent adjusters for business. Consequently, it has not had the same degree of success as the New York Committee. Furthermore, the extent of the territory covered does not permit of standardization to the same extent possible in a small territory, for the general character of claimants varies with location and types of business.

The General Adjustment Bureau operates in the New England States, Middle Atlantic States and Delaware, Maryland, the District of Columbia and West Virginia, except in the New York metropolitan area where it adjusts only about 1% of the losses. It has been in operation for about twenty-eight years and has a membership at present of about 195 stock companies.[2] It employs a staff of 252 adjusters on a salaried basis. The charges for the services rendered by the bureau are based upon the salary scale of the adjusters assigned to a given loss. A loading of 60% is added to the salary of the adjusters to cover overhead and

[1] Insurance Almanac, Op. Cit., 1929, p. 506.

[2] Proceedings of the National Board of Fire Underwriters, Op. Cit., 1929, p. 93.

supervision expenses. The total cost of a given adjustment is assessed against the interested companies in proportion to the insurance carried by them. The General Adjustment Bureau settles annually about 40,000 losses amounting to over $60,000,000, the average size of the 1928 losses being $1,289.[1] The General Adjustment Bureau has a reputation for being strict in its adjustments and has been criticized repeatedly by member companies for its failure or refusal to countenance "soft" adjustments.[2]

There is, at present, a plan of forming a "Fire Companies' Adjustment Bureau,"[3] and the General Adjustment Bureau will be the first to be absorbed.[4] Steps are being taken in this direction, but how far the plan has proceeded has not yet been made public.

The Southern Adjustment Bureau.

The Southern Adjustment Bureau was established in 1909.[5] It is another organization belonging to fire insurance companies. It adjusts fire, tornado, marine, windstorm, automobile and similar losses in the states of Alabama, Georgia, Florida, South Carolina, North Carolina, Tennessee and Virginia. It is the only company adjustment bureau operating in that territory, and no other adjustment agency in the territory in any way compares with it. About 60% of all claims in the states covered are handled by the Southern Adjustment Bureau. Independent adjusters take care of from 35% to 40% of the claims[6] Very few staff adjusters of individual companies settle claims in this district, and the perceentage of losses handled by them is very small. Brokers and local agents handle a few inconsiderable loss claims.

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[1] Ibid., pages 94-96.

[2] Ibid., p. 96.

[3] See Chapter II.

[4] At present, May 1, 1930, the General Adjustment Bureau is still an independent corporation. Events in the South made it wise to absorb the Southern Adjustment Bureau first and it is now The Southern Adjustment Branch of The Fire Companies Adjustment Bureau.

[5] Insurance Almanac, Op. Cit., 1929, p. 532.

[6] Roberts, E. P., Treasurer, Southern Adjustment Bureau, Atlanta, Ga., letter, July 22, 1929.

The Southern Adjustment Bureau adjusts the great majority of the larger claims in its district, although from time to time some independent adjusters are also interested. It has been in operation for something over twenty years and has a selected corps of well educated and trained adjusters. While in most sections of the United States the Independent Adjusters perhaps comprise a more mature and better qualified class of adjusters than those employed by adjustment bureaus, the opposite is the case in the above named states. The adjusters employed by the Southern Adjustment Bureau are on a salary basis and are employed continuously. Fifteen branch offices are maintained, each employing from two to seven adjusters. In addition about ten staff adjusters operate from the main office at Atlanta.[1]

Pacific Coast Adjustment Bureau.

The need for an adjustment bureau on the Pacific Coast did not arise as early as in the East. Up to the end of the nineteenth century, the population was sparse and traveling was difficult. Since extreme economy of traveling expenses was necessary, the special agent nearest the scene of a fire would normally adjust the loss whether his company was interested or not. This practice led to indifference in loss adjustment, and the Fire Underwriters Association held meetings to discuss loss problems with the special agents.[2] At first, independent adjusters established themselves in the larger cities of Portland, Oregon, Spokane, Washington and San Francisco, California. Later, as the volume of business grew, independent adjusters opened offices at other strategic points.[3] Finally, the work of loss adjustment became separated from the producing end of the insurance business and adjusting became a specialized branch of the industry. One of the greatest advances in loss adjustment in the Pacific territory was the standardization of forms used in writing insurance. A Standard Forms Bureau was established to furnish companies with printed

[1] Ibid.

[2] Gibbons, W. H., Pacific Coast Adjustment Bureau, San Francisco, Calif., letter January 20, 1930.

[3] Gibbons, W. H., Op. Cit.

forms covering every type of risk written, except those requiring special treatment.[1] Prior to the establishment of the Pacific Coast Adjustment Bureau, the meeting system was used in settling claims. The practice on the coast was similar to that in the East, except that the meetings to agree on adjusters, were conducted under the direction of the Board of Fire Underwriters.[2]

The need of an Adjustment Bureau on the Pacific Coast was very seriously felt at the time of the San Francisco fire in 1906.[3] The large number of adjustments necessitated by this catastrophe had to be settled without the use of adequate machinery. A few years later, the insurance companies began to think about establishing an organization to render service to policyholders and to aid the companies to adjust their losses promptly, equitably and economically.[4] On December 18, 1911, the Pacific Coast Adjustment Bureau was incorporated.[5] Offices were opened originally at San Francisco and Los Angeles, California, Portland, Oregon, Seattle, Wash., and Butte, Mont. At present, seventeen branches are maintained, covering the states of California, Oregon, Washington, Idaho, Montana, Utah, Nevada and Arizona, and fifty-nine adjusters are regularly employed.[6] The capital stock of the Bureau is owned by 106 member companies, and a board of directors composed of seven company managers guides its affairs. The Pacific Coast Adjustment Bureau operates over an area of 753,954 square miles or one-quarter of the entire United States.[7] No other similar organization covers such a vast territory.

The Southwestern Adjustment Company.

Up to the year 1903 there were no adjustment bureaus in the States of Texas, Arkansas or Oklahoma. Losses were being adjusted by the state or Special Agents in connection with their other

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[1] Ibid.
[2] Ibid. See also discussion on the meeting system in Chapter II.
[3] Pamphlet, Pacific Coast Adjustment Bureau, San Francisco, Calif., Aug. 15, 1929, p. 1.
[4] Ibid.
[5] Ibid.
[6] Ibid, p. 2.
[7] Ibid.

duties of organizing agencies for the production of business.[1] The duplication of effort, resulting from the assignment of adjusters by companies individually, was largely responsible for the appearance of the first adjustment bureau in this territory. In December of the year 1903, E. P. Bates organized the Bates Adjustments Company to handle the loss claims referred to it.[2] The plan was a success from the start, because of the economy in time and expense, since one adjuster was able to represent all companies interested in any given loss. Mr. Bates continued to operate the bureau until 1920. He maintained two offices and a force of employees sufficient to care for the business in the different territories.[3]

The Southwestern Adjustment Company was organized on January 1, 1920, with headquarters at Dallas, Texas.[4] It was formed to cover the states of Oklahoma, Texas and Arkansas. However, the business in the State of Oklahoma was sold in 1924 to the Fuller Adjustment Company.[5] At present, branch offices are maintained at twelve cities.[6] Announcement was made on January 17, 1930, that the Wilson Adjustment Company of Denver, which has been in operation since 1906, will consolidate with and become a part of the Southwestern Adjustment Company on February 1st.[7] When this consolidation has been effected, the Southwestern Adjustment Company will operate in five states, namely, Texas, Arkansas, Colorado, Wyoming and New Mexico, as well as in Mexico, Central America and the West Indies.[8] The consolidated companies will have nineteen offices with forty-eight adjusters in the field. The Southwestern Adjustment Company is not owned or controlled by insurance companies.[9] It adjusts

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[1] Fuller, G. H., 215 Merc. Bldg., Oklahoma City, Okl., letter Jan. 18, 1930.

[2] Ibid.

[3] Ibid.

[4] Insurance Almanac, Op. Cit., 1928, p. 489.

[5] Fuller, G. H., Op. Cit.

[6] Insurance Almanac, Op. Cit., 1928, p. 489.

[7] Texas Insurance, Dallas, Texas, January 17, 1930, p. 12.

[8] Texas Insurance, Op. Cit. p. 4.

[9] Ibid.

all classes of losses, even maintaining a casualty office, and, in its territory, does the work of a company adjustment bureau. The same is true of the Fuller Adjustment Company in the state of Oklahoma.

Company Controlled Adjustment Bureaus.

Since 1901, there has been a steady trend toward the company adjustment bureau. This movement has marked the beginning of more scientific loss adjustments. Bureaus and loss committees have had a great deal of influence in correcting adjustment evils. The need for specialized adjustment machinery which is independent of the producing end of the fire insurance business was recognized before the end of the last century. It required twenty-five years of progress, however, before all sections of the country were provided with the services of adjustment bureaus. Of the adjustment agencies studied, the loss committee (organized on the plan of that of the New York Board of Fire Underwriters) appears to be the best, in theory at least. A loss committee has a wider choice of men to handle a given loss. Some of these men are specialists in losses of particular kinds, as for example warehouse losses, building losses, textile machinery losses, etc. In theory also, the ablest men are independent adjusters, because the compensation seems to be greater in that field. To the extent that committees and bureaus are able to avail themselves of a wide range of choice of men for any given loss, adjustments are more nearly perfect, provided other conditions are equal. Companies using independent adjusters directly do of course have the above advantage, except that a single company is more subject to the influence of politicians, brokers, etc., in making its choice of adjusters. Again, individual companies are prone to employ adjusters as cheaply as possible, within limits, and consequently are more apt to secure men who are incompetent to handle a given loss. Specialization of adjusters in specific types of loss seems desirable, and large scale control or unification of adjustment is consequently advisable.

A lesson may be taken from the Associated Factory Mutual Fire Insurance Companies in this respect. Here twenty-eight

companies specializing in large manufacturing risks combine for inspection and adjustment purposes, and make possible the employment of specially trained men for these important functions. The manager of the inspection and adjustment department of the Associated Factory Mutuals stated that it takes years to train men to handle adjustments, and salaries as high as $10,000. per annum are not unreasonable.[1]

In dealing with the advantages and disadvantages of present adjustment organizations, especially those of the stock companies, theories only can be advanced, since the companies have not yet been able to cooperate wholeheartedly in solving the problem. The bureau or committee is apt to become merely a machine unless carefully guarded and ably managed, while the independent adjuster often takes on more work than he can properly attend to. The company bureau has only its own salaried staff to pick from. This in itself is not a disadvantage, except for the fact that its men are not the most competent, because of the need to keep expenses down. Considering the hesitancy of companies to allow their adjustment bureaus to pay salaries sufficient to build up staffs of the most competent men and also to support them wholeheartedly, the committee type of agency similar to the Committee on Losses and Adjustments of the New York Board of Fire Underwriters is the most satisfactory.[2] This Committee has available all adjusters, whether company staff, or independent, who have been approved by the New York Board. The opportunities thus afforded to vary the skill of adjusters in accordance with the type of losses to be adjusted, and to allocate expenses directly to the specific losses for which adjusters are used, are in a large measure responsible for the success of the system. As long as politics or the policy of expediency of individual companies can be kept in the background and not be permitted to influence the choice of adjusters for given losses, the committee system is quite satisfactory. In New York City this system has apparently aided

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[1] Mowry, C. W., Manager. Inspection Department, Associated Factory Mutual Fire Insurance Companies, Boston, Mass., 1929, Interview.

[2] Haid, Paul L., Proceedings of the National Board of Fire Underwriters, Op. Cit., 1929, p. 87. Mr. Darlington, ibid, 1926, p. 78.

in checkmating the practice of brokers in influencing the attitude of individual companies by increasing or decreasing business.[1] On the whole, a marked improvement in fire loss adjustment conditions has resulted from the establishment of the various adjustment bureaus.

The Growth of Cooperation in Adjustments

The entire history of loss adjustment practice up to this point shows that progress toward a more satisfactory settlement of loss claims has been limited and conditioned by a lack of company cooperation. Success has been achieved in direct proportion to the extent of cooperation.

Cooperation in Loss Adjustments Slow in Developing.

Cooperation in loss adjustment, however, has been very slow in developing. While loss adjustment bureaus, committees and salvage organizations have been in existence since the beginning of the present century, they have not received the full support of the companies interested. Independence of action has been maintained as a vested right, especially with regard to the smaller losses. There is, of course, good reason for exercising independence of action in certain cases of loss adjustment. The risks on the books of the various companies are not comparable. It may be the policy of certain companies to seek the highest quality of risks and of others to take whatever risks are obtainable. Naturally, the adjustment policies of the companies are not the same. When two or more companies are involved in the same loss, these

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[1] The blame cannot be placed on any given company or companies, but must be laid to the general unwillingness of individual companies to buck the tide. The case in point may be illustrated by a quotation:

".....and that is the making of gratuitous payments in various forms. There is hardly a month goes by that in any office, word is not received from an agent or broker that all the other companies on a given loss have paid or agreed to pay, and your company is the only one outstanding, and payment is requested. The fear that prompts all of us of being put in an unfavorable position leads us to act accordingly."

(Discussion of report of Committe on Adjustments, Proceedings of the National Board of Fire Underwriters, Op. Cit., 1926, p. 74-76).

varying adjustment policies come into conflict. The one company may feel that the risk is of such a high character that no question should be raised regarding liability for the claim. The other company may be in the habit of trying to reduce all claims to a minimum. Under the circumstances there should be cooperation through a common adjustment agency, but this is possible only if the adjustment bureau involved adopts a liberal point of view and adjusts the loss on its merits and without undue emphasis on technicalities. The adjustment of losses is not entirely an engineering problem. Regard must be had for the human element involved, which often is the most important factor.

As has already been pointed out, the organization of loss adjustment bureaus was well under way before the outbreak of the World War. The establishment of these adjustment agencies aided materially in solving adjustment problems. The unusual conditions during the war and post war period, however, gave rise to situations that could not be controlled. Shortly after the outbreak of the World War, active steps were taken by the National Board of Fire Underwriters to consolidate and unify adjustment practices throughout the United States. A Committee on Adjustments had been appointed as early as 1912 to secure cooperation in adjusting conflagration losses,[1] and the work of this committee was now enlarged to include the work of investigating and eradicating adjustment evils, which were becoming more numerous and serious because of the war. This committee does not, however, have any power in effecting adjustments, although it does employ a general adjuster. It serves to clear losses in case of conflagrations and maintains special equipment to use in such emergencies. In 1927, for example, this committee acted in fourteen cases of arbitration. It also gives opinions on fire losses and the liabilities of companies.[2] A number of special agents have been employed to cooperate with various adjustment agencies in settling the more intricate claims.[3] The activities of

[1] Cyclopaedia of Insurance, Op. Cit., p. 5.

[2] Ibid. 1928, p. 67-8.

[3] Employees of the National Board no longer enter into adjustment activities but confine their attention to arson cases.

these special agents have resulted in the saving of considerable money for the companies, especially in the adjustment of losses from questionable fires.[1] The Committee has also sponsored a number of special "regional investigations"[2] into general conditions affecting the moral hazard. These investigations have brought about an improvement in adjustment conditions. An important branch of the Committee's work has been the standardization of expense statements, proofs of loss, forms for apportionment of blanket and specific insurance, etc.[3] It has also rendered a number of special services. An example is the development of a correct scale of unit costs for adjusters to use in settling losses at West Palm Beach in 1928.[4]

Committee of National Board Recommends Reform.

The National Board of Fire Underwriters through its Committee on Adjustments undertook an investigation of the adjustment situation in 1916.[5] The committee made a preliminary report in 1917 in which the following recommendations were made:[6]

(1) A more cordial support of existing adjustment bureaus.

(2) A return to the custom of waiting 60 days before paying losses of over $100.

(3) The withholding of payment of all losses of suspicious origin until maturity or until agreement is reached.

(4) More careful investigation of all such losses.

(5) Full cooperation of all members in supporting salvage bureaus.

It was discovered, however, that the time was not opportune for putting these reforms into effect.[7] But committee members were convinced that some progress toward uniformity of action should

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[1] Proceedings of the National Board of Fire Underwriters, Op. Cit., 1925, p. 70.
[2] Ibid. p. 69.
[3] Ibid. p. 67-86.
[4] Report of Committee on Adjustments, Op. Cit., 1929, p. 80.
[5] Report of Committee on Adjustments, Proceedings of the National Board of Fire Underwriters, New York, 1917, p. 120.
[6] Ibid.
[7] Report of Committee on Adjustments, Op. Cit., 1918, p. 74.

be made to reduce the waste of time and money in the adjustment of losses. The following concrete plan of cooperation was submitted to the membership of the National Board in 1918:[1]

"Except as hereinafter provided the General Adjustment Bureau, Western Adjustment and Inspection Company, and Southern Adjustment Bureau, will have authority.....within the respective fields covered by each, to take charge of the adjustment of every loss involving three or more companies, members of the National Board."

The exceptions enumerated were:

(1) Specific locations or districts may be excepted by any company upon written notice.

(2) Upon notice, companies may have their own adjusters or agents represent them in any given loss.

(3) Losses in which a question of liability exists may be handled by the companies directly.

The replies received by the committee to the above proposal indicated that the plan did not have sufficient support to succeed. Then the committee recommended that efforts to evolve a plan satisfactory to all be continued.

Unsatisfactory Loss Adjustment Practices.

The abnormal conditions of the war and post-war periods resulted in many unsatisfactory adjustment practices. Business conditions were not normal. Prices rapidly advanced to new high levels. Fire losses increased tremendously.[2] The effect was to emphasize the seriousness of the adjustment situation. In 1918 in some sections of the United States widespread conspiracies embracing policyholders, adjusters, dishonest lawyers and dishonest agents and brokers were reported.[3] The records of the Actuarial Bureau and the Arson Committee showed careless

[1] Ibid.

[2] The amount of fire loss in the United States increased from $258,377,000 in 1916 to $560,548,000 in 1926, every year except 1919 showing an increase over the previous year. Proceedings of the National Board of Fire Underwriters, New York, 1928, p. 156.

[3] Ibid, 1918, p. 39.

handling of adjustment and loss payments and a tendency on the part of claimants, and even adjusters and agents, to exploit the companies.[1] The Committee on Adjustments of the National Board of Fire Underwriters cited a number of typical cases of fraud in its report in 1919.[2] While careless and unfair adjustments were apparently in the minority, there was enough abuse in the system of handling losses to warrant the spending of considerable time and thought to a plan of supervision that would unify adjustment work. Consequently, the Committee on Adjustments was empowered in 1921 to act for the National Board of Fire Underwriters in conducting an investigation into conditions affecting losses and loss adjustments.[3] The committee was requested to associate with it a committee of general adjusters and also to employ investigators loaned by the committee on incendiarism and arson. The following specific irregularities in adjustments have been cited:

(1) Careless and loose methods in handling adjustments.[4]

(2) Numerous cases in which two companies paid the loss on the same fire.[5]

(3) Numerous cases in which different companies settled the same loss on the basis of different valuations, the valuations varying as much as 200%.[6]

(4) Claims paid where no fire at all has occurred.[7]

(5) Failure on the part of adjusters to ascertain that given claimants had had previous fires and bankruptcies.[8]

(6) Too hasty payment of losses of an apparently incendiary origin.[9]

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[1] Ibid.
[2] Ibid.
[3] Ibid, 1921, p. 57.
[4] Report of Committee on Adjustments, Op. Cit., 1919, p. 93-7, and 1922, p. 34.
[5] Ibid, 1922, p. 93-7.
[6] Ibid.
[7] Ibid.
[8] Ibid.
[9] Ibid, 1921, p. 57.

(7) Corrupt methods of adjusting losses.[1]

(8) Slipshod work of adjusters is very general.[2]

(9) Non-support of company adjustment organizations.[3]

(10) Freedom with which agents are allowed to select adjusters and even make their own adjustments.[4]

(11) Growing practice of agents and brokers of recommending to clients public adjusters from whom fees are accepted.[5]

(12) Profiteering in loss adjustments in all parts of the country.[6]

For years there had been a keen realization of the steadily increasing gravity of the adjustment situation, but it had been impossible to develop any constructive thought on the subject.[7] The chief difficulty was the inability of insurance companies to agree upon a plan which would effect a complete cure of the unsatisfactory adjustment conditions.[8] Deeming it inexpedient to recommend anything which might be considered radical or difficult of performance, the Committee on Adjustments in 1926 merely presented a resolution suggesting that a list of recommended adjusters be maintained by the National Board.[9] It was thought that an initial step in the direction of control over adjustments could thus be taken. Reports of gross inequalities, excessive and fraudulent claims and competitive and hasty adjustments continued to be received.[10] In June of 1927, Mr. Harvey W. Russ, former Assistant General Manager of the General Adjustment Bureau, was engaged to make a survey of adjustment conditions throughout the country. The reports submitted by Mr. Russ are

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[1] Ibid, 1922, p. 77, 79 and 80.
[2] Ibid.
[3] Report of Actuarial Bureau, Proceedings of the National Board of Fire Underwriters, New York. 1924, p. 68.
[4] Ibid.
[5] Ibid.
[6] Presidential address, Proceedings of the National Board of Fire Underwriters, New York, 1925, p. 36.
[7] Presidential Address, Proceedings, The National Board of Fire Underwriters, Op. Cit., 1926, p. 41.
[8] Report of Committee on Adjustments, Op. Cit., 1926, p. 68.
[9] Ibid.
[10] Report of Committee on Adjustments, Op. Cit., 1927, p. 70.

not available to the public, but they are no doubt responsible for the action taken in 1928 and 1929 by the National Board of Fire Underwriters toward forming a "Fire Companies' Adjustment Bureau."

The Fire Companies' Adjustment Bureau

The study of the fire loss adjustment situation has revealed numerous evils which still exist, and prominent adjusters in all parts of the United States are emphasizing the necessity for more rigid control of loss adjustments.[1] They believe that it is a matter of very vital concern to correct existing improper practices as nearly a half billion dollars is paid out annually upon the authorization of adjusters. To do this, however, centralized control by either the companies themselves or some other authority is necessary. The difficulty of obtaining the wholehearted cooperation of fire insurance companies has also been revealed. Those who are leaders in the movement for a unification and coordination of the adjustment system have been proceeding slowly and cautiously, however. Step by step they have been attempting to secure further cooperation. Not until in the Spring of 1928 did they feel the time was ripe to propose any drastic reform in adjustment procedure. A plan for the establishment of the Fire Companies' Adjustment Bureau was worked out in detail and finally presented at the meeting of the National Board of Fire Underwriters in May of 1928.[2] The report was tabled, however, and a special meeting called to consider it. The proceedings of this special meeting are not available.

The 1928 Plan for Unification of the Adjustment System

The Committee on Adjustments in its annual report in 1928, recommended certain changes which were deemed necessary to correct existing abuses and place the adjustment of losses on a

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[1] Report of Committee on Adjustments, Proceedings of National Board of Fire Underwriters, Op. Cit., 1929, p. 81.

[2] Report of the Committee on Adjustments, Proceedings of the National Board of Fire Underwriters, Op. Cit., 1928, p. 70-72.

proper plane. While these recommendations were not drastic enough to accomplish a much needed reform in the method of settling losses, they were vigorously opposed by some members and the plan was for the moment defeated. The chief features of the 1928 plan were (1) the organization of a Central Bureau operated by a Board of Directors to exercise control of loss adjustments, (2) the incorporation of all existing adjustment machinery in this Adjustment Bureau, (3) the automatic assignment to the Bureau of losses in excess of $100 if the insurance is in excess of $25,000 or if two or more companies are interested, (4) the use by the Bureau of all existing agencies of the National Board and the development of other agencies that may become necessary.[1] It will be noted that one of the chief features of the plan is the provision for the automatic assignment of losses. This provision was modeled after that of the Committee on Losses and Adjustments of the New York Board of Fire Underwriters. The automatic assignment of losses is one of the strong features of the Committee plan. The absence of this feature in the provisions regulating the present company adjustment bureaus has been an obstacle to their complete success. It may be stated

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[1] Ibid., p. 70. The plan in full, as described in the Committee's report, follows:

"The Committee on Adjustments has during the year devoted much interest to the adjustment situation, a subject which has been before the companies through your Committee for a number of years past. It is our unanimous opinion that it is very desirable in principle, in the best interest of fire insurance, to set up a central control of the adjustment machinery in this country under the sponsorship of the National Board of Fire Underwriters, through its Committee on Adjustments, and by agreement upon such rules, regulations and procedure in connection with the adjustment and payment of losses as may be desirable and in the interest of all concerned.

"It is therefore recommended that there be organized the Fire Companies' Adjustment Bureau, a corporation without capital stock, organized for service not profit, its membership to comprise the companies members of the National Board, which may delegate authority to an Executive Committee or a Board of Directors, to be selected from the membership of the Committee on Adjustments.

"It is proposed that the existing company adjustment organizations be incorporated into this Bureau, the Bureau to utilize them as branches, establish new ones where expediency and good business judgment dictate, and consolidate conflicting bureaus.

safely that the success of the proposed plan for a "Fire Companies' Adjustment Bureau" will depend to a very great extent upon the support given to this automatic feature by the individual companies.

A Modified Plan Adoped in 1929.

After much modification of the 1928 plan for centralized control of adjustments, it was again introduced at the 1929 meeting of the Board and was approved after numerous reservations had

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"The Committee on Adjustments of the National Board either in itself or through its Executive Committee or Board of Directors, shall be charged with the duty of appointing the General Manager of the Bureau and through him the managers of the several bureaus or branches, and these men shall be directly responsible to the Executive Committee or Board of Directors appointed by the Committee on Adjustments.

"In the development of its staff, to the desirable independent adjusters throughout the country will be given an opportunity to become salaried employees of the Bureau.

"All losses of all companies members of the National Board will automatically be handled by the Fire Companies' Adjustment Bureau where the aggregate loss is estimated to be in excess of $100 and the insurance to be in excess of $25,000, or where the aggregate loss is estimated to be in excess of $100, and two or more companies are interested in the same loss or assured.

"Any company may have its own full time, salaried employee act in the adjustment of losses or any company not having a salaried employee or a salaried adjuster available may assign an independent adjuster on a loss; the companies wishing to take such action must notify the territorial branch of the Bureau. All adjusters of the Fire Companies' Adjustment Bureau and its branches must be salaried employees.

"At its discretion the Fire Companies' Adjustment Bureau may employ, at its headquarters and branches, attorneys and accountants on a salary basis.

"In cooperation with the Committee on Fire Prevention and Engineering Standards, the Committee on Incendiarism and Arson of The National Board, the Committee on Adjustments will develop to their fullest usefulness to the stock fire insurance companies members of the Bureau, the services of the salvage corps or fire patrols, and of the special arson investigators, also the loss records of the Actuarial Bureau. The object of these latter features, is to have all the services maintained by the companies participate for the benefit of the companies.

"Furthermore, the Bureau shall arrange to apprise all of its adjusters, through its branch offices, of trade conditions throughout the country, classes of stock undergoing change, and in general keep the force which

been made by individual members.[1] The plan as approved provides as follows[2]:

(1) A bureau is to be organized to be known as the "Fire Companies' Adjustment Bureau." It is to be a corporation with no capital stock, and is to be operated for service and not profit. Its members are to be identical with that of the National Board of Fire Underwriters.

(2) The Bureau is to be controlled and operated by the Committee on Adjustments through a sub-committee.

(3) The functions of the Adjustment Bureau are to be:

(a) To promote efficiency and to develop correct loss adjustment practice.

(b) To act as a clearing house of loss adjustment information.

(c) To cooperate with other services maintained by the National Board.

(d) To secure and publish accurate data, for the use of adjusters, on trade conditions throughout the United States and to train and educate adjusters.

(e) In general to organize and maintain and control a high grade staff of salaried adjusters to handle every feature of fire and windstorm losses.

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is paying out the companies' money fully informed upon business conditions in the various industries.

"We have reached a point in the conduct of our business where the control of adjustment of losses must be wholly in the hands of the companies, and we believe that the above plan will accomplish this end. This Committee recognizes that it will take considerable time to put this machinery into full operation, but it is confident that the time and money expended toward that end will aggregate a huge saving to the fire insurance companies in the handling of this most important branch of their business. We, therefore recommend to the Executive Committee approval of the plan as outlined, with such further details as may be desirable to effect the proposed organization, and that the Committee on Adjustments be empowered to put the plan into effect upon favorable action by the Executive Committee and its adoption by the annual meeting of the Board in May next."

[1] Proceedings of the National Board of Fire Underwriters, Op. Cit., 1929, p. 98.

[2] Ibid., p. 83.

(4) The Adjustment Bureau is to take over as soon as feasible all existing company owned adjustment bureaus and operate them as branches. Independent adjusters will also be absorbed as opportunity offers. The personnel of the head office and each branch office is to include attorneys and accountants on a salaried basis to cooperate with the adjusters. Adjusters must be on a salaried basis, either monthly or daily at the discretion of the manager.

(5) When fully organized, enlarged and properly equipped with personnel, each branch is to automatically take over the adjustment of all fire and windstorm losses of all member companies where two or more of them are interested and where the aggregate loss is estimated to be $1000 or more, or where the aggregate insurance amounts to $50,000 or more.

(6) Any company may act individually in any manner it sees fit in the adjustment of any given loss upon proper notice to the territorial office of the Adjustment Bureau.

A loophole, stated above as provision number six, was necessary in order to secure the adoption of the plan. In the discussion which followed the presentation of the Committee's report. At least one member[1] made it clear that his company, in the adjustment of its losses, would use the "Fire Companies' Adjustment Bureau" or any other agency that it seemed wise or expedient to use. In other words, the new machinery will be used as and if an advantage can thereby be gained. Fear of the creation of a monopoly was expressed, not because a monopoly is in itself undesirable but because of possible bureaucracy in the settlement of losses. It is argued, that a company which is exclusive in the selection of its risks, i.e., selects a very high grade only, must be more liberal and reasonable in its loss adjustment policy. There must be flexibility in the plan if it would succeed.

Wholehearted Cooperation Necessary to Assure Success of Plan.

It is thought that the automatic assignment of loss feature of the new plan, after the branches are properly equipped, will do

[1] Proceedings of the National Board of Fire Underwriters, Op. Cit., 1929, p. 86.

away with the influence of brokers and agents in the assignment of adjusters to losses.[1] It is doubtful, however, if such will be the case immediately, considering the absence of whole-hearted cooperation in carrying out the plan and the opportunity to act independently afforded by its terms. Furthermore, some action regarding small losses is absolutely essential, since the handling of small losses affords the broker and agents opportunity to influence loss adjustments, although a radical departure from present practice is not desirable. It is significant that some progress toward better adjustment conditions has been made. There is good reason to believe that, given time, the new plan will meet with considerable success. It is similar to that followed by the Committee on Losses and Adjustments of the New York Board of Fire Underwriters, which seems to be the most successful adjustment organization in operation at present. Experience in Massachusetts, where public opinion in one city demanded the automatic assignment of losses and got it, further shows the possibilities of the plan. In Cook County, Illinois, also, the adjustment situation was changed from one of utter demoralization to a high state of efficiency and justice because the companies were willing to relinquish the use of their own discretion in the assignment of losses for adjustment.[2] This proves that the success of the new adjustment agency will depend upon the support given it by individual companies and the manner in which small losses are handled. With such cooperation its opportunities for service are manifold.

Decentralized Control of Adjustments.

Grave doubts as to the advisability of vesting complete control over adjustments in a central committee, such as the Committee on Adjustments of the National Board of Fire Underwriters, has been expressed.[3] It is claimed, such complete centralization

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[1] Paul Haid, Proceedings of the National Board of Fire Underwriters, 1929, p. 88.

[2] Proceedings of the National Board of Fire Underwriters, 1929, p. 88.

[3] John Platt, Vice-President, Insurance Company of North America, Philadelphia, Interview, January, 1930.

should not be necessary for the solution of the loss adjustment problem, and that there may be danger in too much centralization.[1] Should underwriters in New York City dictate regarding the adjustment of fire losses in San Francisco? Centralized control of adjustments and automatic assignment of losses are a necessary part of a program to correct the evils in adjustment. A separate loss committee for each of several geographical districts might be formed, so that the companies doing business in the various districts would have their loss adjustments controlled by men familiar with special conditions in that locality. After all, it is a united action in a given locality or on a given loss that is desired and not necessarily centralized control for the United States as a whole. It would of course be desirable to provide a central committee to act in an advisory capacity and to render other services of value to adjusters wherever situated.

The Principal Service Rendered

The greatest opportunity for service open to the "Fire Companies' Adjustment Bureau" is in the gathering and dissemination of information and in the apprehension of dishonest claimants. Adjusters in all parts of the United States must have available information concerning various kinds of business and also concerning the past history of all claimants. A specialized organization operating from a central office is essential in providing this aid. The cooperation of the companies is especially desirable in handling losses of questionable or dishonest nature. It is claimed, on the other hand that cooperation in this respect is not helped by compelling companies to settle all their losses in a cut-and-dried manner or in having the impression prevail that there is no distinction between different classes of companies.[2] Certain companies claim to have an individuality in some phases of their business. This individuality is valuable to them and to their policy-

[1] Ibid, Proceedings of the National Board of Fire Underwriters, Op. Cit., 1928, p. 72 and 73.

[2] John Platt, Vice-President, Insurance Company of North America, Philadelphia, January, 1930, interview.

holders, and ought to be preserved. Standardization of adjustments, they claim, should not be carried to great extremes.

There is ample room for cooperation without going to extremes. It is necessary to coordinate the work of the Arson Committee of the National Board with that of adjusters in charge of loss settlements. Many of the evils in loss adjustments are the outgrowth of the improper handling of dishonest claims. The "Fire Companies' Adjustment Bureau," therefore, has an important line of activity already laid out for it. The adjustment of losses from fires of incendiary or suspicious origin may be placed in the hands of a central authority with advantage. Such losses may be strictly adjusted, and every technicality may be taken advantage of by the adjuster. However, the same procedure ought not to be followed in dealing with claimants who are honest in every respect. It would seem advisable, therefore, not to require the automatic assignment of all losses to a central bureau, where they might be treated too coldly. There is some advantage to companies in dealing with their high grade claimants, directly, at least until after the Bureau has had a period of trial. Grave injury to the insurance business might result from a too sudden transference of all adjustments to a central bureau with a standardized procedure.

CHAPTER III

LOSS ADJUSTMENT AGENCIES AND PERSONNEL

Present Loss Adjustment Agencies

Many features of the machinery available for the adjustment of fire loss claims have already been indicated. The subject of Adjustment Bureaus has already been adequately treated, but there are other questions of importance requiring consideration. The present system of loss settlement is necessarily the result of a long period of evolution. Changing business conditions have caused changing insurance methods. These changes in turn have been reflected in the methods employed to settle losses. The present machinery of loss adjustment should be adequate to solve all problems arising. However, no institution is exactly suited to accomplish the purpose for which designed. The machinery of loss adjustment is no exception. There always has been a lag in its development. New problems continuously arise, and time is required to change the machinery to suit the new conditions.

The amount of fire loss adjusted annually exceeds $400,000,000.[1] The individual fire loss claims making up this total are settled by means of the following agencies:

1. Brokers or other local agents.
2. State or special agents.
3. Salaried staff adjusters.
4. Adjustment bureaus and committees.
5. Independent adjusters.

In addition to using the above agencies, companies find it necessary from time to time to employ experts in various phases of business to give technical advice regarding specific matters arising during the course of an adjustment. The insured who has suffered a fire loss, on the other hand, may personally nego-

[1] See Chapter I.

tiate the settlement of his claim with the representative of the companies, or he may employ an adjuster to represent him. He also may find it necessary to employ a technical expert to secure advice on some phase of the adjustment.

Importance of Each of These Agencies.

In an effort to determine the territory covered and the proportion of adjustments handled by each of the adjustment agencies, letters were sent to the managers of the leading adjustment bureaus in the United States. There are eight of these company adjustment bureaus, whose activities cover almost the entire territory of the United States.[1] These organizations in nearly all cases are supervised and directed by the companies themselves, and the membership of the companies varies with location. The table on page 56 has been made up from information received by letter, and from other sources as noted.

[1] Report of Committee on Adjustments, Proceedings of the National Board of Fire Underwriters, Op. Cit., 1924, p. 69.

Adjustment Bureau	Replied to Letter	Answers to Question on Percent of Losses Adjusted in Territory by each Agency						1928 Loses Pd. in Each Dist. by Stock Cos.
		Adjustment Bureau Answering	Other Adjustment Bureaus	Staff Adjusters of Cos.	Independent Adjusters	Brokers & Local Agents	Other Agents	
Com. on Losses and Adjs. New York Bd. of Fire Underwriters	Yes	60	1	25	14	0	0	$ 25,000,000
Gen. Adj. Bureau	No	65[1]						86,150,205
So. Adj. Bureau	Yes	60	0	Very small	35-40	Very few	0	32,034,726
Cook Co. Loss Adj. Bu.	No	(In territory of Western Adj. & Inspection Co.)						
Western Adj. & Insp. Co.	Yes	50	25	5	10	8	2	101,087,146
Underwriters Adj. Co.	No	(In territory of Western Adj. & Inspection Co.)						
Southwestern Adj. Bur.	Yes							22,507,722
Pac. Coast Adj. Bur.	Yes							30,354,808
Texas Adj. Bureau, Fuller Adj. Co., Bates Adj. Co., etc.								13,888,237
TOTAL								$ 311,022,844

[1] Estimated on basis of following data: In 1928 General Adjustment Bureau adjusted 12½% of all losses in U. S., see Proceedings National Board of Fire Underwriters, 1929, p. 95; Stock Companies paid $311,022,844 losses in 1928, see "Fire Insurance by States," 1929, p. 126; $111,150,205 of these paid losses were in states covered by the General Adjustment Bureau, namely Me., N.H., Vt., Mass., R.I., Conn., N.Y., N.J., Del., Md., D.C., W.Va., and a small portion of Virginia adjacent to the District of Columbia, see "Fire Insurance by States," 1929, p. 126; Metropolitan New York not covered by General Adjustment Bureau except for about 1% of losses; has about $25,000,000 of losses, Rpt., New York Board of Fire Underwriters, 1929. Total Fire losses amount to about $500,000,000 annually in the U.S. The General Adjustment Bureau has settled losses amounting to $633,705,205 since 1921. See Proceedings of the National Board of Fire Underwriters, 1929, p. 95. It must, therefore, settle between $60,000,000 and $90,000,000 annually.

The table is quite incomplete, and yet conclusions may be drawn from it. On the basis of the estimates given for territory involving about two-thirds of the total losses, it is calculated that company fire loss adjustment bureaus adjust over 50% of the claims. The proportion handled by salaried staff adjusters of individual companies varies greatly according to the section. The same is true regarding the proportion taken care of by independent adjusters. Brokers and local agencies settle a very small percentage of claims. Their influence is much more potent in the selection of adjusters than in the actual adjustment of losses.

Adjustment Organization of Individual Companies.

The fire loss adjustment department is not uniformly organized in the various companies. In some companies, it is very large, in others small. Some companies employ salaried special agents, who do other things in addition to loss adjustment. They write insurance, train salesmen, advise brokers, and adjust small losses. In some cases special state agents are employed to supervise local agencies placing insurance, and with whom adjusting losses is a side line. In other companies, salaried staff adjusters supervised by a general adjuster are employed. In such a case, the general adjuster is given a great deal of responsibility. In some cases he has the power of a Vice President. If a loss is of a doubtful nature, one which could be legally defeated, and he thinks it wise policy to pay it, he can immediately deal with the assured. Neither of these systems is ideal; the first fails because unqualified men sometimes are charged with adjusting losses, and the second, because of a policy of expediency which may be followed in settling with the insured. It is doubtful whether an adjustment department can be placed on a strictly formal basis, so that a uniform policy worked out in advance may be followed in every case. As long as an adjustment organization is maintained by an individual company, there is a possibility that it will act for the best interests of that company. Consequently, uniformity in adjustment practice is not possible unless all claims which are in the slightest degree irregular are settled by an Adjustment Committee

or Bureau. Regardless of the agency used to adjust losses, final approval of any settlement must emanate from the home office. Adjusting Bureaus, Independent Adjusters, Brokers and others handling adjustments are not vested with general authority but in doubtful cases must report the facts fully to the respective company officials and receive specific instructions. Adjustment Bureaus, being organizations of many companies, are more uniform and strict in their loss settlements. Sometimes they are too technical in their attitude toward claimants. Consequently, it often happens that a claimant, either personally or through the broker who sold him his policy, requests that an independent adjuster or a special agent of the company handle his case. The object of such action is either to gain an advantage through a liberal adjustment or to escape an unjust settlement. Special agents and other auxiliary adjustment agencies are often subject to pressure. Adjustment bureaus on the other hand are sometimes too exacting in attempting to cut the loss to a minimum. They should be used exclusively for incendiary, dishonest or suspicious claims. If they deserve the reputation of trying to get all losses down as low as possible regardless of the equities involved, their attitude should be modified.

The Activities of Brokers and Agents in Adjusting Losses.

As already indicated, brokers and local agents are directly charged with the settlement of a small percentage of the total amount of losses. The losses handled by them are usually small, however, and so, they are involved in a much larger percentage of the number of losses than the preceding figures indicate. Since many of the special agents and staff adjusters are directly interested in selling insurance (theoretically, brokers and local agents are not qualified to adjust fire losses) their influence in picking adjusters and in influencing the policy of settling losses is not conducive to a sound adjustment policy. A very striking statement was made by Mr. Paul L. Haid in supporting the plan for organizing a "Companies Adjustment Bureau." He said.[1] ". . . .it is well

[1] Proceedings of the National Board of Fire Underwriters, New York, 1929, p. 87.

known to almost every man in this room that loss adjustments are now assigned largely by producers, either agents or brokers....." As a practical matter the adjustment of very small losses can be left to brokers and special agents until such time as it becomes possible to eliminate them entirely, but immediate steps should be taken to curb their influence on the adjustment policy as a whole. The following quotation from the Report of the Committee on Adjustments of the National Board of Fire Underwriters shows that the evil is sensed by some leading insurance men:

"If we could bring about an absolute separation of the loss adjustments from the production of premiums, a fundamental reform of the adjustment evil would be effected. Wherever we find the producer and the adjuster allied, directly or indirectly, we find an inefficient adjustment of losses.

"This phase of the difficulty would be solved if the companies directly assumed their true responsibility for adjustments without directions or pressure from the agents."[1]

As recently as May, 1929, the attention of insurance men was brought to numerous instances of incompetency and of lax methods in adjustments.[2] The Committee on Adjustments of the National Board of Fire Underwriters has made investigations which show that great pressure is being brought, by brokers and other producers, for so called "soft adjustments." Numerous instances have been brought to light proving that, upon the insistence of the claimant's broker, losses are often referred to specific adjusters who are noted for their laxity. It was stated at the 1929 meeting of fire underwriters that the company adjustment organizations have their best men spend a large part of their time in soliciting from their own members losses to adjust.[3] There is something to be said on both sides of this question. As already indicated, many companies feel that they write a high grade of risks, and that they do not wish to have all of their

[1] Proceedings of the National Board of Fire Underwriters, Op. Cit., 1924, p. 70.

[2] Report of Committee on Adjustments, Proceedings of the National Board of Fire Underwriters, Op. Cit., 1929, p. 81.

[3] Paul L. Haid, Proceedings of the National Board of Fire Underwriters, Op. Cit., 1929, p. 87.

losses settled on a uniform basis. They claim that they owe it to themselves and to their policyholders to preserve a certain degree of individuality in loss settlements. Their contention is, that all claims should not be handled in the same standardized, technical and impersonal manner. It may be necessary at times to follow the advice of local or special agents in selecting an adjuster to handle certain loss claims in order to make sure that high grade policyholders receive considerate treatment.

The Use of Experts.

Experts are employed from time to time by both the companies and claimants. These experts are in no sense adjusters and should not be classed as such, but are employed to give expert advice regarding special phases of adjustments such as the extent of the damage, the value of the property before the fire, the value of the salvage, the cost to repair or recondition, the quantity or quality of inventories on hand, etc. These experts may be builders, furriers, jewelers, engineers, salvors, accountants, lawyers, electricians, or any one of a great variety of specialists.

An insurance adjuster is presumed to have a knowledge of practically everything necessary to settle fire losses at least in his district, but, as a practical matter, this is not entirely true. The adjuster is ordinarily able to handle the usual run of losses coming his way, but there are so many industries and so many technical processes, especially in the larger cities, that no one man can be an expert in every one. It is often necessary to secure the services of an expert who has spent his life in a given business.[1] This is true in the case of some fur losses, where experts are usually required, particularly to establish the kind, grade and value of the furs involved. It is out of the question to expect an adjuster to be familiar with a highly technical trade in which he is not engaged. In the case of building damage, it is also necessary to determine the cash value as well as the loss or damage, and since the insured frequently does not have confidence in the adjuster's ability to determine these questions, the employment of

[1] Harrington, George, Op. Cit.

a builder or contractor is frequently resorted to. An ordinary builder does not always have the knowledge and experience necessary to aid in adjusting a loss. In most cases, a builder who specializes in restoring buildings damaged by fire is to be preferred. The value of experts in reducing excessive or dishonest claims, in cases where the true facts are withheld or are not known, is very great. The establishment of "the day of fire value" of machinery and the damage done to a particular machine by reason of a fire, likewise is more or less a difficult matter, and, frequently, a man entirely familiar with the value of used machinery and the cost of restoration as of the day of the fire is employed.

If the loss is on a class of merchandise where the market is very unstable, it would probably be necessary for the adjuster to consult a man who is in daily contact with that particular product. This might be well illustrated by a policy covering a radio stock where styles change almost over night. Even so-called staples, such as silks and linens, are subject to style and manufacturing changes.[1] In general, wherever such questions as the above arise an expert should be employed as a protection both to the company and to the insured. The original estimate sheets, schedules, statements and other data prepared in writing by such experts as builders, engineers, salvors, accountants, appraisers, etc., are also very valuable in case of court action. Reports of experts consulted should in all cases be signed.

Adjustment Machinery of Mutual Companies.

Mutual Fire Insurance Companies in many cases make use of the same adjustment facilities as the stock companies. Replies to a questionnaire sent to the mutual companies indicate that a large number of them maintain no adjustment organization of their own. Others cooperate with stock company adjusters and accept the settlement made by them. Because of their specialization in specific types of risks, such as grain elevators, flour mills or factories, other mutual fire insurance companies main-

[1] Harrington, George, Op. Cit.

tain staffs or adjusters especially trained and skilled to care for the needs of their policyholders. Usually, however, a mutual company covers too large a territory or too wide a variety of risks to employ single handed a sufficiently skilled staff of adjusters. Since a wide spread of risks is desirable, and since extreme specialization is not always possible, mutual fire insurance companies have formed associations to take care of certain of their functions, notably loss adjustments. The Mutual Fire Prevention Bureau of Chicago is such an organization. This Bureau has ten millers' mutual fire insurance companies as active members and employs a staff of adjusters to settle claims.[1]

The Associated Factory Mutual Fire Insurance Companies also will serve as an example of how some mutuals are cooperating for adjustment and other purposes. This association comprises twenty-eight mutual companies insuring special manufacturing risks in the East.[2] An Inspection Department is maintained which supervises inspections, valuations, fire prevention and loss adjustments. Attention is given first to correct underwriting and prevention of loss. The number and extent of losses is reduced by adequate inspection of all risks periodically. The problem of loss adjustment is to a certain extent solved prior to the occurrence of a fire by appraisals of the plant and by correct underwriting. As a consequence the adjustment of losses becomes relatively easy. All adjustments are carried on through the Loss Division of the Inspection Department at Boston in cooperation with the managers of district offices at Chicago, Philadelphia and Cleveland as well as resident inspectors at Charlotte, North Carolina, and Toronto, Canada.[3]

Another excellent feature of the system followed by the Associated Factory Mutuals is the practice of self-adjustment of small ordinary losses. The claimant merely sends in a complete statement of his loss without consulting the adjuster. The insured's statement is audited and usually accepted by the general adjuster.

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[1] Letter, Mutual Fire Prevention Bureau, Chicago, 1929.

[2] Mowry, C. W., Op. Cit.

[3] Manufacturers Mutual Fire Insurance Co., Providence, R. I., Report, 1928, p. 37.

In this manner 60% of all fire losses (by number) are adjusted without the necessity of calling in an adjuster.[1] There is no definite figure set which determines whether a loss is to be adjusted or audited, the idea being to have all small losses audited by the insured and thus save the expense of sending an adjuster, which in many cases would be in excess of the amount of the claim. However, if the facts as presented show the loss to have been one that might serve as a lesson or one involving peculiar circumstances, then, either an adjuster is sent or an Inspector in that territory is asked to investigate and make a report. If the loss is of any consequence, an adjuster visits the risk immediately. Not only does this practice cut down the expense of adjusting losses, but it also promotes cooperation on the part of policyholders. Of course, it must be remembered that only very large, selected, manufacturing risks are carried by companies in the Association. The membership of these companies is made up of such a high class of business men, and the adjustments so fairly made, that the largest and oldest of them boasts a record of ninety-three years of service without a single lawsuit over a loss settlement.[2]

The Cost of Adjusting Losses.

It costs surprisingly little to adjust fire loss claims. Twice as much could be spent on loss adjustment and still the cost would not be excessive, provided accurate, just and satisfactory loss settlements were secured. In 1921 the average cost of adjustments for the 175 companies reporting to the National Board of Fire Underwriters was 1.70% of premiums earned.[3] In 1922 it was 1.91% for the 174 companies reporting. Based on losses paid, these percentages would be about 3% and 3½% respectively. A questionnaire sent to mutual fire insurance companies brought the information that it costs them about the same as it does the stock companies reporting to the National Board. The replies reveal a variation in cost ranging from 2% to 4% of losses paid

[1] Mowry, C. W., Op. Cit.
[2] Manufacturers Mutual Fire Insurance Co., Op. Cit. p. 36.
[3] Proceedings of the National Board of Fire Underwriters, Op. Cit., 1922, p. 34.

for ordinary losses. Nearly all indicate a cost of from 2% to 3% of losses paid. One company makes the interesting statement that, while its experience has shown an adjustment cost of less than 1% of losses paid for its entire business, the cost of small losses rises to an average of 15%. In other words, it is about fifteen times as expensive to adjust small losses as large ones.

In some cases, the per diem charges of adjusters have been ascertained. They range from $10.00 to $25.00 plus expenses. $15.00 was the most frequent citation. Data were also obtained showing the cost of adjusting losses of the Committee on Losses and Adjustments of the New York Board of Fire Underwriters. For the period from 1922 to 1927 inclusive, the cost on the average was 3.85% of losses paid, ranging from 3.19% in 1922 to 5.18% in 1927.[1] This is about the same percentage as given for all companies reporting to the National Board, but, in view of the fact that the losses adjusted by the Committee on Losses and Adjustments of the New York Board of Fire Underwriters are, on the average, considerably larger than for the country as a whole, its adjustment expense ratio is relatively higher. This is in accord with the previous conclusion, that a higher rate is paid by it for adjusters' services. It is interesting to note also, that it costs the New York Committee over $100 per loss, on the average, for adjustment expenses.

The General Adjustment Bureau reports that it costs $20.95 per $1000 of losses paid to adjust losses in 1928. This figure includes a 60% loading, which is added to adjusters salaries for overhead and supervision.[2] The cost of adjusting losses experienced by the General Adjustment Bureau is lower than that of the Southern Adjustment Bureau, the Western Adjustment Bureau and the Committee on Losses and Adjustments of the New York Board of Fire Underwriters.[3] The cost experienced

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[1] Annual Report of Committee on Losses and Adjustments, New York Board of Fire Underwriters, New York, 1928.

[2] Proceedings of the National Board of Fire Underwriters, Op. Cit., 1929, pages 94-95.

[3] Ibid.

by the last named on a comparable basis was $32.76 per $1000 of losses paid.

The composition of the adjustment expenses is also interesting. For 1927 the various groups of expenses of the Committee on Losses and Adjustments of the New York Board of Fire Underwriters were as follows:[1]

Adjusters' Services	$213,077.60	27%
Appraisers and Experts	184,546.94	24%
Lawyers' Fees	178,028.89	23%
Lawyers' Disbursements	29,027.55	4%
Accountants' Charges	35,373.58	4%
General Expense (Salaries, rents, etc.)	137,108.47	18%
TOTAL	$777,163.03	100%

It will be noted from the above that the cost of employing technical experts, including lawyers and accountants, is greater than that for adjusters. In all 203 different appraisers and experts were employed at one time or another during the year while only 69 different adjusters were employed.

Loss Adjustment Personnel

The machinery used by the companies in settling losses has been considered. Of greater importance, perhaps, is the personnel operating this machinery. No organization is stronger than the men who constitute its motivating force. The success of the Adjustment System of the United States is largely dependent upon those charged with the actual settlements with claimants. The adjusters must meet those suffering fire losses and negotiate for their companies settlements of the claims arising.

The Adjuster Represents the Company.

The insurance companies are forced to deal with claimants through their representatives, the adjusters. The time has long

[1] Annual Report. Op. Cit., 1928.

since passed when the President or some member of the board of directors could visit and personally deal with a claimant. However, when a fire occurs, the insured wants to deal with the company just as truly as did his predecessor over a hundred years ago. To him, the adjuster is the physical embodiment of the company. The company is studied and judged by the actions of the adjuster. If the adjuster represents an Adjustment bureau, he is the visible or tangible representative of the institution of fire insurance. If the adjuster is reckless, unjust, and illiberal, the insurance companies represented are so in popular estimation.[1] If, however, he deals with a claim honorably and fairly then the insurance company or the institution of insurance is judged to be prudent, just and safe.

Adjuster's Qualifications.

At some time or other, practically every qualification of successful insurance men has been mentioned as being required of an adjuster. Willis O. Robb, at one time Secretary of the Committee on Losses and Adjustments of the New York Board of Fire Underwriters, has said:[2]

"An adjuster, like any other business or professional man, may be considered as composed of three elements,—natural character, general culture, and specific or professional training. Now, the weak spot in the armor of the average adjuster is to be sought, in my judgment, not in what he was by nature and inheritance before he learned anything, nor in the specific training he has received as an adjuster, but in that intermediate region of the general education he received, or gave himself, before his specific training began. In other words, it is neither in character nor in technical education that an adjuster is so likely to be deficient as in general culture."

While none of the three elements mentioned by Mr. Robb should be undervalued, the eminently practical virtues of the ad-

[1] See quotation from Insurance Agent, 1868, contained in The Insurance Cyclopaedia, I. H. and C. M. Goodsell, Chicago, 1871, Vol. I, p. 200.

[2] Willis O. Robb, Men and Methods in Loss Adjustment, Proceedings of the Fire Insurance Society of Philadelphia, 308 Walnut Street, 1904, p. 7.

juster, such as, integrity, quick intelligence, self-control, resourcefulness, a keen sense of justice, courtesy and tact may be developed and strengthened by education. Whether inherited or developed, these and other qualities must be possessed by an adjuster before he undertakes special technical training.[1] It has often been said that adjusters are born and not made.[2] While it is true that some men are given a better inheritance for a given kind of work than others, any man of ordinary intelligence and judgment can so educate and train himself that he will be able to succeed at any kind of a job to which he may apply himself.[3]

"But the business of adjusting losses is not learned in a day, nor in a year. It is a business that requires study, observation, and close application to details. There is always something more to learn about it; there is always something new coming up. In fact, every fire loss carries its own problem. The country has few first class adjusters; but it has an army of second, third and fourth rate men drawing pay as first class adjusters. The trouble with those who grade below par is that they imagine that because they have handled a few losses, they qualify for front seats, and there is nothing more they have to learn."[4]

The specific technical training required by a first class adjuster may be indicated by outlining the points made by Willis O. Robb in a lecture on the subject, as follows:[5]

1. The adjuster should be familiar with the policy's printed conditions and the usual forms, clauses, riders, restrictions and permits attached to it.

2. He should know something of the historical development of the several provisions of the present policy, their earlier forms, and the legal, commercial, and practical reasons which led to their change.

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[1] Ibid.

[2] Handling Loss Adjustments, Mutual Fire Prevention Bureau, Chicago, 1929, p. 291.

[3] Ibid.

[4] Ibid.

[5] Willis O. Robb, Op. Cit.

3. He ought to have a thorough knowledge of insurance law and be familiar with the various constructions placed upon policy provisions by the courts.

4. He must have a knowledge of accounting principles and practices.

5. He should be able to estimate in detail the cost of common brick and frame buildings.

6. He ought to be familiar with the price of various kinds of destructible property such as furniture, wearing apparel, ordinary machinery, equipment and stocks of merchandise.

7. He should have an extensive knowledge of the staple articles of commerce and their manufacturing processes and costs.

8. Above all he should know the sources of information that he may require from time to time in his work.

Important as the specific knowledge is to the adjuster, however, it must be placed second to general judgment and capacity to employ facts.

"An adjuster deals not only with losses, and with the meaning of contracts of insurance against losses, but also with human beings, made up of all manner of racial and personal peculiarities, and encountered in all possible states of mind, and it is even more necessary that he should be an expert in this branch of his profession than that he should perfect himself in the other two."[1]

The adjuster must be able to gain the confidence and respect of claimants and draw them out. He must meet every man on his own level. Claimants will contend for many things not provided for in the policy or will attempt to collect more than the value of the property destroyed.[2] The adjuster "must bring such unreasonable people to their senses—must teach them insurance law and prove to them insurance practice, and having moderated their surprise, must leave them satisfied that the company has permitted them to sustain no loss, and has acted handsomely throughout."[3]

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[1] Willis O. Robb, Op. Cit., p. 17.
[2] Insurance Agent, Op. Cit.
[3] Ibid.

In view of the specifications enumerated above it will be seen that it is not an easy matter to recruit a suitable adjustment personnel. A long period of education and training is necessary. Consequently, a sufficient incentive in the way of a salary and opportunities for the future must be held out to young men entering the profession. It is not accurate to hold that every former agent, solicitor, broker or even manager is fitted by his previous experience to adjust losses.[1] Companies need to take a long run point of view in the development of adjusters. Young men with a suitable foundation in cultural education should be selected and given a technical training under the supervision of experienced adjusters. This plan is now being followed by at least one adjustment organization. It has been maintained, however, that there has been during the past seven or eight years a gradual decline in the esprit de corps and in the ability of the young men coming into the field of loss adjustment.[2] The adjustment field as a whole is less attractive than formerly, especially in the service of company adjustment bureaus. The more capable adjusters are setting up in business for themselves. Mr. Darlington in discussing the situation at a recent meeting of the National Board of Fire Underwriters said,[3]

"There is hardly a man working for an adjustment bureau or in a company organization who is not able to go out and open a little office of his own and on the morrow double his income. The fact of the matter is that at the present time the men who are adjusting losses for us, through our organizations, are held over because of their lack of initiative, lack of confidence in themselves, more than anything else. There is not a man who starts out to be an adjuster who is not making twice and three times the salary he can make working for an organization. The result is that what we have left are not the best. The best men are the men who leave the organization."

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[1] Willis O. Robb, Op. Cit., p. 8.

[2] Discussion by Mr. Lane of Report of Committee on Losses and Adjustments, Proceedings of the National Board of Fire Underwriters, Op. Cit., 1926, p. 69-73.

[3] Discussion of Report of Committee on Adjustments, National Board of Fire Underwriters, Op. Cit., 1926, p. 78.

It is hoped that the "Fire Companies' Adjustment Bureau" when organized will create an educational office under competent direction to undertake this work of training adjusters.[1]

Public Fire Loss Adjusters

Very closely related to the subject of adjustment personnel is that of Public Fire Loss Adjusters. In some states all adjusters whether private or public are required to meet the same qualifications and are subject to the same regulations. The qualifications of the private adjusters, just considered, apply to those serving the policyholders as well as those serving the companies. The duties of adjusters serving the property owners differ slightly from those of company adjusters, but they are, nevertheless, a part of the adjustment machinery, and, where found, perform some of the functions ordinarily performed by company representatives. Furthermore, the laws of some states, in regulating adjusters, do not distinguish clearly between those representing the claimants and those representing the companies. It seems desirable, therefore, to discuss the subject of public adjusters at this point rather than in connection with the discussion of the insured in Chapter six. Much of the material in Chapter six, however, also applies to public adjusters, since company adjusters sometimes are forced to adopt special tactics in dealing with them.

Public adjusters are not universally employed by policyholders, presumably because of the expense involved. It would seem, that the insured is entitled to expert representation in a loss adjustment just the same as the company. It would also seem that the expense of this counsel should be borne by the insurance companies as being part of the service purchased with the insurance premiums. At present, however, such is not the case, for company or independent adjusters are provided to perform this service and ordinarily are expected to occupy a disinterested position, although agents of the insurers. Public adjusters are very frequently employed by claimants who make every effort to profit

[1] Proceedings of the National Board of Fire Underwriters, 1929, page 89.

from a fire by matching wits with the company adjusters. As a matter of fact, the employment at present of a public adjuster by the claimant is held to indicate in many cases, that either the claimant is endeavoring to drive a hard bargain with the company or the public adjuster has forced his services upon him. Everything possible should be done to remove the stigma from the public adjuster, since his services are necessary in building a more scientific adjustment procedure.

History of Public Adjusters.

Public adjusters first appeared in the late eighties. Many of these adjusters were reputable and rendered very valuable services to both the companies and the policyholders in the settlement of claims. The fees collected were sometimes large, especially those offered by the policyholders. The opportunity for gain in this profession attracted less scrupulous individuals and before long the ranks were crowded. The fee system of payment for services originated at this early date has been responsible for untold evil practices in the adjustment profession. The corruption of public adjusters was detected from the beginning by insurance companies. The loss committee of the New York Board of Fire Underwriters recognized the ultimate effect of such practices but seemed unable to prevent their growth. In its report to the Board in 1910 the Committee referred to public adjusters as follows:

"In the Metropolitan District there are about twenty firms—individuals or partnerships—regularly engaged in the adjustment of fire claims for the public, employing considerably more than one hundred persons as clerks, solicitors, inventory-takers, etc. A few of these concerns confine their operations to Brooklyn, but most of them handle losses throughout the territory of the Exchange, and even outside of it. Of the entire number, not more than six have any considerable proportion of high grade people among their clients....(and not excepting any of them) the public adjuster's business comes to him almost wholly through arrangements with certain brokers, with whom he divides (for the most part equally) the commissions he receives for the adjustments. Ordinarily the insured is ignorant of this arrangement...These standing

arrangements with brokers are at the bottom of much of the evil in the business.....That commission itself, while supposed to be ordinarily in the neighborhood of 5% is sometimes 1% or even less; sometimes 10% or even more, according to the exigencies of the case, the character of the competition, the ignorance of the insured, etc....The committee has from the beginning done what it could by its conduct of each separate adjustment to penalize, directly or indirectly, the mishandling of claims for claimants."[1]

The companies have sought the aid of the various insurance commissioners in solving the problems arising from the practice of public adjusters on the ground that companies are not able to cope with the situation. As recently as 1925 the situation was discussed by the President of the National Board of Fire Underwriters as follows:[2]

".....Fire insurance.....should not be a prey of profiteering when fire occurs, yet there are public adjusters who buy claims from the assured and settle with the underwriters at a profit. Inasmuch as the companies must necessarily deal with the assured's representatives, they are unable to effect a correction of this evil, which obtains in some degree, in all parts of the country. Again, the division of adjusting fees by public and independent adjusters with brokers who supply business is another evil which the companies cannot correct....."

The situation respecting public adjusters in New York City has improved somewhat since the above report was written. Two of the evils cited still exist, however.[3] One is the lack of qualification of those holding themselves out to be experts in rendering service of this nature. The other is the fee system of payment for service in handling the insured's loss claims. The insured still pays the public adjuster from 5% to 10% of the amount collected on the loss. This fee is in most cases excessive compensation. Furthermore, the fee should be based upon the amount of service rendered, rather than on the amount collected Some very large losses are adjusted quickly and require

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[1] S. R. Weed, Op. Cit., p. 573-5.

[2] Proceedings of the National Board of Fire Underwriters, Op. Cit., 1925.

[3] Harrington, George, Op. Cit.

little effort, while oftentimes a small loss will require much more time and attention to secure justice for the claimant. The public adjuster often has two things in mind when undertaking an adjustment for which he is to collect a percentage fee. In the first place, he may endeavor to make the loss as high as possible so that the fee will be high. In achieving this, he may be willing to take advantage of the company if opportunity affords. In the second place, he may make every effort to settle the loss in as short a time as possible, so that he can turn to something else. He may take advantage of the insured, his client, if necessary to bring about this result.

The methods of obtaining losses to adjust often lead to corruption and bribery. Three methods have been employed,[1] namely: personal solicitation, which in extreme cases has resulted in the employment of so called "night riders" to follow up fire alarms; splitting commissions with brokers; and conspiring with the insured to burn his property and collect from the insurance company.

Public fire loss adjusters in other jurisdictions enjoy a more favorable reputation.[2] A questionnaire was sent by the author to fire marshals in various parts of the United States and Canada asking them what unsocial practices are followed by public and independent fire loss adjusters. Replies were received from most of them. In no instance was there a citation of unsocial practices being followed at present. In a few cases past experience of evil practices of adjusters was mentioned. A questionnaire was also sent to the Insurance Commissioners of the various states, asking what unsocial practices are followed by public and independent adjusters. Thirty-eight of the forty-nine insurance commissioners answered. Fifteen stated that no unsocial practices were to the best of their knowledge being followed. Nineteen did not answer the question directly or referred to other sources of information. The commissioner of a state in the middle west

[1] Ibid.

[2] The Insurance Department of the State of Pennsylvania is at present in the midst of a survey of the field of public adjusters, but no results are yet available.

stated that public adjusters are unnecessary and a nuisance in the majority of cases. He claims that they prey on the ignorant and that they have even encouraged arson, and so, in the new code revision of 1929, bonds are required of them. From a New England state comes the statement that some adjusters resort to "strong arm" methods to secure business by representing that they are "state inspectors" who have been delegated by the state to handle the claim or by threatening to give supposedly derogatory information concerning the claimant to the company if the claimant refuses to employ them.

It is difficult to draw any definite conclusions from the replies received from Fire Marshals and Insurance Commissioners, since they do not all interpret the questions in the same way. The replies indicate, however, that there is no widespread tendency on the part of public adjusters to adopt unsocial or evil practices in adjusting losses. The evils that do exist are confined for the most part to the large cities.

Extent of State Regulation of Adjusters.

The unsocial practices of public adjusters, independent adjusters, and in some cases company adjusters, have resulted in the passage of state laws controlling their activities. Most of these laws regulate independent as well as public adjusters, while some relate only to the latter. Detailed information has been collected concerning the practice in all the states of the United States. Only nineteen states make any attempt to regulate adjusters, other than to impose a privilege or occupation tax. In only five states is an examination made a requirement for obtaining a license. A tabulation has been made showing the practice in sixteen of the states.[1] (See table on page 75).

[1] Based on application blanks and laws of the various states.

States Requiring Adjusters to Obtain a License

State	Public Adjuster Specifically Included	Including Independent Adjusters	Company Adjusters Included	Examination Required	License may be refused, revoked or suspended for cause	May Insurance[1] agent or broker be public adjuster for compensation
Alabama	No	Not Stated	Not Stated	No	Not Stated	Not Stated
California	Yes	Yes	Yes	No	Yes	No
Connecticut	No	Yes	Not Stated	Yes	Not Stated	Not Stated
Idaho	No	Yes	Yes	No	Not Stated	Not Stated
Maine	No	Yes	Yes	No	Not Stated	Not Stated
Massachusetts	Yes	No	No	Yes	Yes	No
Michigan	Yes	Yes	Not Stated	Yes	Not Stated	Not Stated
Mississippi	No	Not Stated	Not Stated	No	Not Stated	Not Stated
New York	Yes	Yes. N.C.	No	Yes	Yes	No
North Carolina	No	Yes	Yes	No	Not Stated	Not Stated
Oregon	No	Yes	No	No	Yes	Not Stated
Pennsylvania	Yes	Yes	No	Yes	Yes	No
South Carolina	No	Yes	Adj. only	No	Not Stated	Not Stated
Vermont	No	Yes	Yes	No	Not Stated	Not Stated
Washington	No	Not Stated	Not Stated	No	Not Stated	Not Stated
Wisconsin	No	Yes	Yes	No	Not Stated	Not Stated

[1] In some states, as in New York, brokers may act as public adjusters provided no compensation is received for services as such.

The laws of only four states, California, Massachusetts, New York and Pennsylvania specifically regulate public adjusters. In most cases the laws are designed for the purpose of creating revenue. In some cases the laws regulating the adjustment of losses are directed specifically against independent or company adjusters and do not mention public adjusters. Such a law is in force in South Carolina. The law of South Carolina excludes public adjusters from its requirements for licensing.

In the California law, the term adjuster is held to include:

"Every person, Partnership, association or corporation advertising, soliciting business or holding himself or itself out to the public as an adjuster of loss or damage by fire, marine, accident, liability or other loss of damage covered by any policy of insurance issued in this state, and receiving compensation or reward for adjusting such loss or damage or for the giving of advice or assistance to the insurer or the assured in the adjustment of claims for loss or damages as aforesaid."

The definition in the Massachusetts law is as follows:

"Whoever, for compensation, not being an attorney at law acting in the usual course of his profession, or a trustee or agent of the property insured, directly or indirectly solicits from the insured or his representative the settlement of a loss under a fire insurance policy shall be an adjuster of fire losses."

The following definition appears in the New York Laws:

"The term, 'Public Adjuster' in this section shall include every person, partnership, association or corporation advertising soliciting business or holding himself out to the public as an adjuster of loss or damage by fire, or receiving any compensation or reward for the giving of advice or assistance to the assured in the adjustment of claims for loss or damage by fire, and all persons who for compensation or reward, whether by way of salary or commission or otherwise, solicit business, investigate or adjust losses or advise the assured with reference to claims for loss or damage by fire, on behalf of any other person, partnership association or corporation engaged in the business of adjusting loss or damage by fire."

The Pennsylvania Law states that a Public Adjuster is:

"any person, copartnership, association or corporation advertising himself, themselves, or itself, as claim adjusters and receiving any compensation or reward for giving advice or assistance to the insured or to any adjustment company or adjuster in investigating or adjusting claims. The act does not apply to agents or employees of insurance companies, associations (Lloyds) or exchanges (reciprocals) issuing the policies under which claim is made, or brokers or agents acting as adjusters without compensation."

The California law seems to be the most specific in its inclusion of independent adjusters although the Pennsylvania law also includes them and also seems to include employees of adjustment companies and any experts consulted in the course of an adjustment. The Massachusetts and New York laws include specifically only adjusters for the assured.

Examination of Adjusters.

As stated previously only five states require an applicant for an adjuster's license to pass an examination. In three of these states, Massachusetts, Michigan and Pennsylvania, the examination must be written. The purpose of an examination is to test the applicants' competence in matters pertaining to the adjustment of fire losses. He should know the insurance laws of his state and be familiar with the court cases relating to the settlement of loss claims. He should be a good judge of property values, be able to handle salvaged material, be up to date on trade conditions in his territory and have a detailed knowledge of a number of kinds of business. Mr. H. R. Teitrick, Chief of the Division of Brokers, Department of Insurance, Commonwealth of Pennsylvania, in a letter, had the following to say regarding the advantages of an examination:

"The first and most obvious advantage in requiring the examination is to safe-guard the public from the activities of unqualified adjusters since in general the public is not prepared or fitted to judge of the qualifications of the adjuster since their contact with the adjuster as individuals is so infrequent. By requiring an examination, the Insur-

ance Department sets a standard which discourages an undesirable element from seeking the license. It is an advantage to qualified adjusters by limiting from competition those individuals who might seek the adjustment of losses with great plausibility but destroy the confidence of the public in public adjusters by the poor type of service given the public."

The application for an adjuster's license is designed to test the personal qualifications of applicants. In the blanks furnished by New York and Pennsylvania, complete information is requested regarding education, nationality, citizenship, and previous experience in adjusting losses. Three states ask for a statement of the extent and character of education, while six require a statement of experience. The moral reputation of applicants is tested by requiring answers to specific questions. References are also asked for, and in many cases statements vouching for the responsibility and integrity of the applicant must be signed by business acpuaintances or insurance companies.

Revocation of Licenses.

Very few of the laws relating to the licensing of adjusters have any provision relating to the revocation of licenses. The strictest laws contain provisions similar to the one in the Pennsylvania law as follows:

"License may be revoked after investigation if such discloses (a) licensee has violated any provision of the act: (b) has made material mis-statement in application: (c) has been guilty of fraudulent practices; (d) has demonstrated incompetency or untrustworthiness to transact business as public adjuster."

They also contain penalties for violation of the Act. Usually such violation is considered a misdemeanor and is punishable by a fine, sometimes as high as $500. The information furnished in the Application for a license must be certified to under oath made under the penalty of perjury. The Massachusetts Law, for example, provides as follows:

"whoever.....being required by law to take an oath or affirmation, wilfully swears or affirms falsely in a matter relative to which such oath

or affirmation is required, shall be guilty of perjury....Whoever commits perjury.....shall be punished by imprisonment in the state prison for not more than twenty years or by a fine of not more than one thousand dollars or by imprisonment in jail for not more than two and one-half years, or by both such fine and imprisonment in jail."

Regulation of Adjusters Not Uniform.

The whole question of control over fire loss adjusters seems to be in a confused state. In the first place, no two states agree exactly in their definitions of adjuster. As stated, four states aim to regulate primarily the activities of adjusters acting for the insured, one or two specify the adjusters acting for the insurer, while most of them mention adjusters in a very general way, seeming to include all adjusters whether acting for insured, insurer, or independently i.e., for insured or insurer as occasion warrants.

In order to place the adjustment of fire losses on a proper professional plane, it seems necessary to require all adjusters to meet the same requirements. The man representing the insurer in a loss settlement should be required to prove his qualifications just as well as the one representing the insured. One of the weaknesses of the adjustment situation is the fact that some losses are adjusted by men who are not properly qualified. If all adjusters were required to meet high standards as a requisite to following their practice, the public would eventually lose their distrust of them. The examinations now given can be passed without any special knowledge of insurance adjusting and without any special training. Furthermore, the license may be obtained by a broker in many cases, and ordinarily he is not qualified to adjust losses. His function is to secure insurance for his client, and his part in adjusting should be limited to representing his client without additional compensation. The state laws should be uniform in not permitting adjusters to adjust losses on a commission basis. The amount settled for is the poorest possible measure of the amount of service rendered in bringing about an adjustment. A fee or per diem rate for the various types of skill required is the only proper method of compensation. This system is followed by

Certified Public Accountants and is more apt than any other to result in disinterested competent service.

Public Adjuster an Economic and Social Necessity.

The public adjuster is economically desirable, because he renders a service to the insured by looking over his policy and advising him as to its meaning and in helping him carry out its terms. The insured is a party to the fire insurance contract just as much as the company is, and he has many obligations to perform after a fire occurs. The public adjuster is of service in helping the insured fulfill his part of the contract. In many cases, the insured is very incompetent in handling a fire loss, and the public adjuster is in a position to render a valuable service in preparing him, as well as the property, for the insurance company adjuster. The public adjuster also renders the companies a very valuable service by performing much of the work of adjusting. The adjuster for the insured and the adjuster for the company, if both are motivated by a desire to secure an accurate and just settlement, can consider the facts without the emotional bias of the insured. Under the present system of adjustment, the insured usually does not even begin to meet his obligations under the policy contract. The company adjuster is forced to waive many provisions of the policy. Such procedure is socially undesirable and leads to the wrong point of view right at the start of negotiations. The policy contract should be interpreted strictly in all cases. This is impossible unless the insured is provided with competent counsel. Two lawyers, one representing each party in a disagreement, can usually adjust matters fairly and quickly without any thought of court. There is no reason why loss settlements cannot be made in the same way. The fire insurance policy might provide that the insured is entitled to the services of a Certified Public Adjuster as a part of his indemnity, and the State might guarantee that all adjusters are qualified.

CHAPTER IV.

APPRAISAL IN FIRE LOSS ADJUSTMENT

The subject of determining the value of the property involved in a fire naturally follows that of loss adjustment machinery. This chapter deals with the subject of the appraisal of property, and the next with the effect on appraisal of laws and court decisions. The fire loss adjuster is faced with a very practical and real problem for he must come to a definite conclusion regarding the value of every piece of property involved in a given fire.

Plant Valuation and Appraisals

Valuation of a Complete Plant as an Economic Unit.

The appraisal of certain kinds of property must be undertaken from the standpoint of the economic unit of which they form a part. It is seldom indeed that a complete plant is destroyed by fire, but there are some principles of valuation which may best be discussed if a complete economic unit is in mind. In valuing even a single building or machine, it may be of importance to ascertain how it is related to the plant as a whole. The value of a business unit is determined on the one side by the marginal demand price of the given product or service it produces and on the other side by the cost of reproducing it.

An economic unit producing given products or services must compete with other units producing the same, or substitute products or services. The prices that can be obtained for these products or services tend to be determined on the demand side by their marginal demand prices and on the supply side by their marginal costs of production.[1] If a given plant or economic unit then produces at costs that follow closely, or equal the costs of a

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[1] Raymond T. Bye, Principles of Economics, Alfred A. Knopf, New York, 1925, p. 324.

marginal producer (i.e. if a given plant or economic unit is continuously a marginal producer) it must be valueless. Its costs of production just equal the prices that can be obtained for its products or services. There is no margin of profit for the owners, and, consequently, the plant has no value. Now, such a plant would not long be continued in operation, since it is immaterial to the owners whether it is operated or not. If costs could not be lowered and if prices did not rise, the plant would soon become idle. In order to have a value then, a plant or economic unit must have production costs below those of marginal plants, and its value increases as its costs are lowered in relation to marginal costs.

On the other hand, as long as a plant or economic unit produces at a cost sufficiently low to earn representative profits, i.e. profits expected of a representative firm, it may be valued at its cost of reproduction, less depreciation.[1] Between the point at which a plant would be abandoned as worthless and the point at which it would be considered as worth exactly its cost of reproduction less depreciation, profits would vary from nothing to the profits of a representative firm.

A representative plant or economic unit is worth more as a going concern than the total value of its separate physical units. Time and effort are necessary to build up a plant composed of bare physical property into a smoothly functioning whole, earning representative profits. The value of the management and technical skill as a composite unit of manpower must be added to that of the cost of physical equipment. Many industrial leaders attribute greater value to the human factor of the plant than to the mechanical part. If the management is superior, larger than representative profits will result, while if it is inferior, smaller profits will result. Consequently, a representative plant, which is well built and well managed, will be worth at least what it would cost to reproduce it less depreciation. And a plant which is not as well managed or not properly constructed will be worth less

[1] The concept "representative firm" is taken from Alfred Marshall, Principles of Economics, eighth edition, MacMillan and Co., Ltd., London, 1920, p. 317.

than its cost to reproduce minus depreciation. Since the human factor of a plant is not covered by a fire loss, the cost of reproduction minus depreciation is the upper limit for valuing a plant or any of its parts for fire insurance purposes, and as long as a given plant is making representative profits and is ably managed, the cost of reproduction less depreciation is a fair basis for valuation. If, however, profits or management are found to be very far below par, the appraiser or adjuster must be on guard to prevent an over-valuation.

Appraisals of the Associated Factory Mutual Fire Insurance Companies.[1]

A group of twenty-eight associated factory mutual fire insurance companies maintains an inspection department to inspect risks, appraise plants, and adjust losses. Appraisals are furnished free of charge to members insuring their plants with any of these companies. After years of experience, an appraisal system which is not an exhaustive survey and compilation of all minute details has been evolved. It is deemed unnecessary and expensive to follow the same procedure as that advocated by independent appraisal companies. Nevertheless, the results have proved to be accurate, differing only slightly from inventories worked out in great detail and at great expense.

The work of the survey is conducted as follows: the buildings and floor areas are measured to determine a square foot basis upon which to make valuations. The size and type of building being known, an accurate value can be determined by using tables generalized from detailed valuations of similar plants. The figures in these tables serve merely as a foundation for the appraiser and must be modified in accordance with his judgment. The appraiser must be a man of great skill and experience in valuing similar properties. The heights of studs, degrees of finish, thickness of walls, fluctuations in market values of labor and materials, depreciation, the size of the buildings and other

[1] Information furnished by C. W. Mowry, Manager, Inspection Department, Associated Factory Mutual Fire Insurance Companies, 185 High St., Boston, Mass.

special features must be considered in applying the valuation tables. After the cost of reproduction is determined, depreciation is deducted. A depreciation table, used by experienced appraisers and based upon years of experience, is available for each specific kind of machinery. It is believed, that the calculating of depreciation will offset any lack of precision in the calculation of cost of reproduction, or putting it another way, that since the depreciation is based on estimate, it is not worth while to spend a great deal of time arriving at a more exact estimate of cost of replacement. Foundations are, of course, excluded in making a valuation, as they are not considered insurable.[1]

An itemized inventory is made of all the larger and more expensive machines and tools. The price of each item is determined in the office and applied by the experts. An elaborate up-to-date file of prices of machinery, equipment and materials is maintained. At the time of valuation these prices are checked against the cost of recent purchases. In making this inventory particular attention is paid to items likely to indicate price trends. An allowance is made for cost of erection, and a deduction is made for depreciation due to age and condition of service as determined by the appraiser.

Furnishings and apparatus are bulked and their value estimated by building or floor space. Small tools in the shop are also lumped and estimated. Foundry patterns are estimated on the basis of the shelf space occupied. All shaftings are valued on a per foot basis with ten percent added for cost of erection and beltings at so much per foot. The piping, heating apparatus, sprinkler system, etc. are estimated on a floor area basis. Electric motors are inventoried and priced, and the wiring involved is valued at so much per horse power. Electric light wiring is valued on a per light basis. Other items are reduced according to the same procedure. If the larger and more valuable items are all included and correctly valued, the appraisal will be as accurate as is necessary for practical purposes. The probable value that the

[1] Some policies, however, cover against damage to foundations caused by water escaping from the sprinkler system.

insurance companies would be held for in the event of a total loss is thus obtained. The survey of the plant indicates any special insurance coverage that is necessary, and so, complete and correct insurance is made possible.

When the appraisal is completed the appraisers' field notes are used in writing up a complete report, and a copy is given to the insured. Revisions are made from time to time as changes or other conditions require. The valuation is, however, never quite up to date and is not final in the event of a fire. The fire insurance policy specifies that the loss shall be measured by the actual value on the date of the fire, consequently an appraisal made prior to that time is not final. This is made clear to the assured by a statement on the front page of the appraisal report in the following words:

"This is a confidential memorandum for estimating the amount of insurance that should be carried to properly protect the property listed, and is sufficiently accurate for that purpose. It excludes the value of all underground work. It is not binding on either party in case of fire for settlement is based on actual values at time of loss."

Nevertheless, the information in the appraisal report and the knowledge gained in making and revising appraisals as well as that gained by periodical inspections is invaluable in the event of a fire loss.

In this discussion of property valuation as accomplished by the Associated Factory Mutual Fire Insurance Companies, no mention has been made of the management, the personal element in property values. The ownership of the property to be valued is highly important, but the fire risks accepted by the factory mutuals are of the very best. Thus, the personal factor is taken into account at the time the risk is accepted, and so, the appraiser and the adjuster need pay no special attention to it.

Valuations of Appraisal Companies.[1]

The valuations undertaken by appraisal companies are in many cases more detailed than those of the mutual companies just de-

[1] From information supplied by American Appraisal Company, Philadelphia, 1929.

scribed. There may be several reasons for this. The purpose of the appraisal may not be only to place insurance or adjust losses. Furthermore, the management of the plant may not be known or may be inferior to that of high grade manufacturing plants, such as those insured by the mutual companies above discussed. Most appraisal companies favor a very detailed appraisal on the ground that no other is dependable.

In making a reproduction appraisal, a preliminary architecural report is usually the first step. This report gives general information concerning the construction of the plant originally and discusses the general condition that would assist or impede construction if at present undertaken. The possible methods of handling materials, the method of excavating and filling, the present costs of brick work and concrete are also considered. Perhaps the most important questions covered in the preliminary report are those relating to material prices, labor rates and other special local conditions governing the purchase and handling of materials and labor and the actual work of construction. The procedure is the same as if the construction of the existing plant were contemplated.

Following a more detailed investigation of the plant, a general report is made concerning the site, the buildings, the equipment, present production conditions, management and other personnel, and prices of labor and materials. A survey of the site occupied is usually made to determine what specific advantages or disadvantages it has. Such subjects as the following must be fully and accurately covered:

1. Facilities for fire prevention.

2. Location with respect to manufacturing, wholesale, retail and residential districts.

3. Transportation facilities for employees.

4. Nature of occupancy of adjoining sites.

5. The special physical characteristics of the site.

6. Possibility of expanding plant on present site.

7. Adjacent streets and improvements thereon in detail.

8. Railroad and water transportation facilities serving site.

9. And in general any economic conditions resulting from location.

The survey of the plant buildings usually includes a history of the plant from the time constructed. It is important, that the time and nature of extensions and changes be given. As noted under the heading of depreciation, the type of construction and the present general condition of the buildings are important considerations in plant valuation. The policy of the management in regard to the maintenance and repair of buildings should be studied and, in connection with depreciation, the question of arrangement of buildings and use of space are vital considerations. Some buildings may be inadequate or unnecessary for present requirements. The layout of the plant as a whole has a decided bearing upon the value of any given building. If the plant were to be reconstructed, alterations in the arrangement, construction, size or plan of buildings might be necessary. There may be portions of the plant which are worthless or on which the depreciation has been especially great. These should be noted in the report. Operating conditions which affect depreciation above or below normal should also be noted.

The machinery and equipment of a plant must be considered in much the same manner as the buildings. The policy of the management, as reflected in the original layout of machines and equipment and the subsequent changes, has much to do with their value as a part of a going plant. The present layout must be described fully and compared to that of efficient up-to-date plants of similar nature. The general physical conditions of the ma-

chinery and equipment in each operating division of the plant and the present policy of its maintenance and repair must receive the same consideration as in the case of buildings. If any material deviation from normal is found in any of these respects, it will have a decided bearing on present value. Other specific points to be covered in a general report of machinery and equipment are:

1. Machines and equipment specially designed and built for the plant.

2. The items of development cost included in the value of special parts of the plant.

3. The capacity of each operating division of the plant as compared with present requirements.

4. The units of machinery and equipment which are inadequate for present production requirements.

5. The units of machinery and equipment wholly or partially obsolete.

6. The units of machinery and equipment which are wholly or partially inactive.

7. Special operating conditions affecting depreciation.

8. The source of power and the methods of transmitting it.

The survey of production usually includes an analysis of the nature of the products manufactured, the rated capacity of the plant and the quantities produced and sold during recent years. The nature and source of raw materials and the nature and means of disposal of by-products are special phases requiring attention. The value of the plant as a producing unit depends upon the value of its product. It is quite essential that any unusual fea-

tures regarding the product or its manufacture and sale be discovered. If a plant is operating on a uniformly profitable basis and has been efficiently constructed, it is quite certain to be worth its reproduction value less depreciation. This fact must be clearly demonstrated by the survey.

Perhaps the most important single feature in the value of a plant is its personnel. Appraisal companies are aware of this, and are careful to include in their general report a full discussion of the management and other employees. The ability of the management is directly reflected not only in profits but in plant maintenance. To have a value at least equal to its cost of reproduction, less depreciation, a plant must have a profitable outlet for its products, must have reasonably low costs of production and must be maintained at a high rate of efficiency. The management is responsible in each case under normal conditions. The survey must cover the source and nature of the labor supply and its attitude toward the management. The attitude of employees toward the management is very important.

The preliminary and general reports just discussed must be followed by a detailed appraisal of the plant and all equipment. If the plant is normal or above normal in all respects it is safe to say that it is worth at least what it would cost to reproduce new less depreciation. Inventory sheets are made out in great detail showing for each unit of property the date constructed or installed, the condition percent, the estimated cost to reproduce new and the total depreciation. This inventory of property is made out in just as much detail as if an identical plant were to be constructed new. Since all values are not subject to destruction by fire, all non-insurable items are eliminated.

When a plant has once been appraised a continuous appraisal service is supplied to keep the appraisal up to date. Records are kept in the appraisal companies' office and periodical inspections are made. The location and condition of every building and

every piece of machinery and equipment is noted on these records and all changes are recorded as they occur. Prices and depreciation rates are adjusted from time to time to meet new conditions, and so, the value of the entire plant or any unit is instantly available.

Value of Plant Appraisals in Placing Fire Insurance and in Adjusting Losses.

The fire insurance policies necessary to cover the plant may be based upon the figures of the appraisal company. If a continuous appraisal service is available policies may be changed to meet new conditions as they arise. In the event of a fire the proof of loss may be made out directly from the appraisal. This practice is followed in most cases, and insurance company adjusters are usually willing to accept such figures. The appraisal companies' records show just what property is involved in any fire. The property involved may be revalued using prices of the day of the fire and depreciation to that day. The extent of damage may be determined by an inspection and the adjustment of the loss quickly made. The appraisal service just considered compares with that rendered by the inspection and appraisal department of mutual insurance companies previously discussed except that it is undertaken in greater detail. These services are, however, available only to certain large insurers. Small property owners should prepare their own appraisals and inventory sheets to aid them in placing insurance and, if necessary, in the adjustment of losses by fire. Brokers are taking an increasing part in valuing property at the time the insurance is placed. They are offering their clients the benefit of engineering skill in obtaining surveys and inspections of the property to be covered. Inspection and appraisals at the time insurance is placed are of inestimable value in case of a fire loss. They not only facilitate the actual valuation of the property destroyed but also are of importance in reaching a satisfactory settlement with the insured, because made by disinterested parties and under normal conditions.

The Appraisal of Individual Items of Property

The conditions within a given business unit which have a bearing on the value of individual items of property have been considered. It is necessary also to consider the subject of appraisal from the standpoint of market conditions apart from the plant. Certain problems involved in the appraisal of movable property and of property used for purposes other than that for which constructed are important also. The factors involved in appraisal vary with the kind of property. Consequently, a classification of property subject to fire loss is necessary. As nearly as possible in the order of simplicity of valuation, the following classification may be made:

1. Movable Property.
   a. New and in perfect condition, in hands of producer, wholesaler or retailer.
   b. New but not in perfect condition, in hands of manufacturer, wholesaler, or retailer.
   c. Second hand, in process of being consumed, in hands of consumer.
   d. Raw materials in perfect condition in hands of manufacturer.
   e. Goods in process, partly manufactured, in hands of manufacturer.
2. Fixed Property.
   a. Machinery and fixtures, installed and in operation in a building.
   b. Buildings or structures used for the purpose constructed.
3. Property used for purposes other than that for which intended.
   a. Materials, Furniture, Fixtures, equipment, machinery, etc. not being used or being used for a purpose other than that for which originally constructed.
   b. Buildings and structures, not being used or being used for a purpose other than that for which originally constructed.

Valuing Movable Property.

By far the easiest class of property to value, is stocks of merchandise in perfect condition in the hands of those producing them or those distributing them to consumers through the regular channels of trade. Of course, this class includes an untold number of different kinds of goods in all stages of marketing. Mr. Brown in an article on stock losses describes this class of property very vividly.[1] He says:

"Stocks may be divided into the three classes— animal, vegetable, and mineral, with their myriads of raw specimens and untold numbers of manufactured or converted products, and may be found in the hands of the original producer, the breeder, fisherman, miner, forester, gardener, or hunter, or the manufacturer, importer, commissariat, jobber or wholesaler, the retailer or department storekeeper, and occasionally the consumer, but wherever the stocks may be, or in whose hands they may be found, the questions for the adjuster are always the same: 'What was the value at the moment of the fire?' and 'What is the damage?'"

The first problems are, of course, the determination of the quantity and quality of merchandise completely destroyed and also the extent of damage to goods partly destroyed. These are problems for experts and have been considered elsewhere.[2] As a basis for settlement, the value of a given commodity of a known grade or quality in perfect condition as at the time and place of the fire must be determined. Theoretically, "the value of a commodity tends toward that point where the marginal demand price coincides with the marginal cost of production."[3] Since a given time and place are known, the price in a given market will be the correct value. What market is to be used, however, in case the commodity in question is bought and sold in more than one? The answer seems to be the market to which the assured has access and would normally resort if he were making a purchase or sale of the commodity destroyed. Thus, the insurance company

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[1] Brown, D. C., Adjustment of Stock Losses, The Fire Insurance Contract, Insurance Society of New York, 1920, p. 415.

[2] Chapter III.

[3] Bye, Raymond T.: Principles of Economics, 1925, Alfred A. Knopf, New York, p. 324.

should be held for a different price in case of a loss involving a wholesaler and a loss involving a retailer. In the case of commodities having a national or international market, the price in that market would have to be adjusted to compensate for transportation and handling cost and a differential allowed for small quantities. The question of time of valuation also enters. The last established price before the fire should be taken, unless the loss in question is so inconsequential as to have no effect on the price. In such a case, a subsequent price, if nearer the time of the fire, may be more accurate. Due to the limited sale of a given commodity or for other reasons, there may be some question as to what is the market price. In densely populated sections of the country, it is usually possible to find some expert who is familiar with the market for practically any commodity, no matter how rare. When the adjuster is not able to determine the market price himself, he should employ such an expert. When no expert is available, the statement of the assured may be accepted, if apparently honest and reasonable.

In the case of stocks of finished goods held by the manufacturer, the same principles of valuation must be followed. It would be incorrect to value such goods at what it would cost the insured to manufacture them in his own plant. Not only is such a procedure contrary to the theory of value, but it also disregards the insured's obligations to his customers and the time required to produce the goods in question. The market price, if it can be determined, must be the measure of the value of goods in the hands of the manufacturer, just as truly as in any other situation. The manufacturer is then entitled to a manufacturing profit or must sustain a manufacturing loss on such goods, depending upon the relation between his costs and the established market price at the time of the loss.

The adjuster must determine the value of a given article at a definite time and place, and so, the "market value" is the correct value. But an established market does not exist for every conceivable commodity. Thus, the concept of "market price" is useful only in valuing those articles for which an established market may be found. If the market price cannot be determined the

question must be compromised on some arbitrary basis that does justice to all concerned.

Goods which are not new or in perfect condition, and do not fall into one of the classes or grades dealt in on the market, must be valued on the same basis as discussed above except that an allowance for depreciation must be made. It is often necessary to employ an expert to determine the amount of depreciation.

The valuation of goods in the hands of the consumer and in the process of consumption offers additional problems. It would seem that the price of such goods in a second-hand market would be an accurate indicator of value at the time of the fire. The insured, however, was not contemplating a sale, but intended to continue consumption of the commodity. Furthermore, a second-hand market is usually very limited in scope, and dealers in that market make allowances for a wide margin of profit. Consequently, the second-hand value of goods is a forced sale value and is nearly always less than the value to a consumer. Furthermore, the second-hand dealer intends to sell to a consumer whose estimate of value will be influenced by the stigma in many cases attached to second-hand goods. The market value of the commodity when new, less a reasonable allowance for depreciation, is fair to all interested parties. If no market price exists, as in the case of a tailor-made suit or custom made furniture, it may be necessary to make calculations on the basis of the original cost to the insured, adjusted for any important price changes and less depreciation. In the case of wearing apparel, one adjuster consistently offers to settle at 50% of cost on the theory that any given individual will own clothes which, on the average, are one-half worn out. This same adjuster allows 25% of cost for depreciation on household furniture. Such a policy is more or less arbitrary, but, in many cases, it is impossible to arrive at a valuation in any other way. The satisfaction of the claimant is always an important consideration.

In valuing raw materials in perfect condition in the hands of a manufacturer, no new problems arise. The market price in the market customarily used by the insured, adjusted to cover hand-

ling costs and transportation charges paid by him, is the correct measure of value at the time and place of the fire.

A new problem is introduced, however, in the instance of goods in process. Such goods sometimes have no market, as such, and ought to be valued at the present cost of reproduction at prevailing prices. Theoretically a profit is not earned by a manufacturer until he has sold his merchandise. Consequently, goods in process cannot be said to have a value in excess of cost to produce under conditions prevailing at the time of the fire. If the market price of similar goods in the finished state is so low as not to warrant their production under prices then prevailing, goods in process must be valued at less than cost of reproduction in order to conform with the values of the finished goods.[1] The importance of the consideration discussed above is shown by the fact that leading underwriters emphasize the necessity for adjusters to have a detailed knowledge of trade conditions in order to be qualified to handle losses.

Valuing Fixed Property.

Before being installed in a plant, machinery and fixtures fall into the first class of commodities discussed, and their value depends upon market prices. When they are installed, however, conditions are altered. In the first place, installation costs must be considered, and, while the cost installed does not always measure the value of machinery and other equipment, nevertheless, machinery and equipment are designed for use in a plant and their capitalized value must include installation costs. For the same reason, after installation their value is not determined wholly by the cost of reproduction less depreciation, but is effected by the success of the undertaking as an income producer. Since machinery may be repaired or replaced on the basis of prevailing market prices the value of a machine is limited to that cost plus installation expenses and minor depreciation. Its value may fall below such cost of repair or replacement less depreciation, when

[1] Some policies, however, specifically provide that in losses of this nature cost of reproduction will be paid regardless of the prevailing market price of similar goods in the finished state.

a study of the market for the products or services supplied by the plant in which the machine may be operating is necessary in determining its value. Further consideration was given to this question in a previous paragraph.[1] It becomes necessary, then, in valuing machinery and other plant equipment to secure the services of an expert. He must first determine whether or not the plant as a whole fits in well in the economic system, and its various units should be valued on the basis of cost to replace, less depreciation. He must then actually determine the value on whatever basis is proper.

No well established market can be said to exist for buildings and structures as such.[2] An important requirement of an established market is a classification or grading of the commodity traded in. It is essential also that there be a considerable number of prospective buyers for every article offered for sale. Buildings are not uniform in size, location, or purpose for which constructed. When once built, a building has a very limited range of usefulness. Buildings also have a long life relative to other commodities. All of these factors complicate the valuation problem.

It becomes necessary, then, to consider the factors influencing the value of a building after it is constructed. These same factors influence the value of machinery and fixtures in somewhat the same manner. In many cases they become virtually a part of the building, and so the following discussion is supplementary to the above discussion of this class of property.

When a building has just been constructed, it presumably has a value equal to its cost of production, since the builder had to compete in the market to secure the necessary materials and labor. There is a fallacy even in this statement unless the building is efficiently constructed, is suitable for the purpose intended, and meets the expectations of its owners in all respects. As soon as constructed, however, the building begins to deteriorate physically,

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[1] Page 81.

[2] See opinion of court in 49 N. Y. Supp. 546, cited in John A. Zangerle, Principles of Real Estate Appraising, The Stanley McMichael Publishing Co., Cleveland, Ohio, 1927, p. 61.

in spite of repairs. Its value also begins to fluctuate because of changes in the values of materials and labor and to improvements in engineering methods. The demand for the services of the building may also increase or decrease, causing changes in its worth.

Once a building has been completed its value will be influenced by, (1) depreciation, including obsolescence, (2) changes in the values of the elements of which constructed, (3) changes in the value of its products or services.

The third factor, changes in the value of its products or services, is important only if it causes a decline in the value of the building below its cost of reproduction less, depreciation. Assuming that materials and labor are available at a price to repair or rebuild, and excepting a certain amount of time necessary for restoration,[1] the value of a building cannot be said to be greater than the expense involved in reconstruction. It would normally be less than that by the amount of its depreciation.

The importance of reaching an agreement with the claimant must be emphasized. In many cases, especially in isolated districts, the adjuster and the insured can arrive at the value of a building by making an itemized estimate, agreeing on each item as they go along. Depreciation must then be determined for each item, except in cases where minor repairs only are necessary. The determination of depreciation in such cases is also largely a matter of agreement. If the adjuster is competent and the insured fairminded a fairly accurate judgment of the damage may be determined. When there is a total loss, much depends upon the plans for rebuilding. When the adjuster is not familiar with construction costs in a given locality or when he cannot agree with the insured, a competent builder may be called in. The employment of a reliable and competent builder, especially in congested districts, is usually the most accurate and satisfactory way to

[1] It is reasonable to suppose that a building just constructed, if well suited for its intended purpose and if efficiently constructed, would bring a price of something more than its actual cost including builders' profit. The time and inconvenience involved in building might produce a differential of up to ten percent.

settle building losses. The claimant in many cases also employs a builder. When the two builders disagree, they go over their estimates together item by item and agree on each before passing to the next.

In case the damaged building is to be restored, it may be advisable to agree that the insured be paid the cost of such restoration less depreciation. This procedure is advisable in cases where it is difficult to determine the exact amount of the damage. Often the whole of the damage is not discovered until repairs are under way.

So far in the discussion of building valuation the commonly used theory of cost of reproduction new, less depreciation or deterioration due to action of the elements, wear and tear, obsolescence, inadequacy etc. has been followed. A survey was recently made,[1] however, which tends to discredit the usual practice followed in valuing buildings according to the above theory. The selling prices of a large number of fair sales of business properties in the state of Ohio were compiled. After checking up on land values and deducting these from total selling prices, the values of the buildings alone were determined. Theoretically this direct method of valuation should yield more accurate results than the indirect method usually followed in building valuation. The results of the survey showed that old buildings as a rule brought higher sales prices in proportion to their cost of replacement, less depreciation than new buildings. It was found that new buildings sold for about ten percent more than their cost and old buildings for from twenty to thirty percent more than their cost to replace new less depreciation.

Of course in buying a business property, a purchaser calculates his costs under various assumptions. If he constructs a building he will be required to invest capital to the amount of at least 100% of its reproduction cost. If he buys the same building after it has lost one-fourth of its service life, he will have to pay somewhat less than 100% of reproduction cost, perhaps only 75%.

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[1] J. M. Cleminshaw, "Actual Cash Value in Building Appraisal," The National Underwriter, New York, January 27, 1927.

In the latter case his annual cost for interest on his investment will be less, and, since he is more apt to be influenced by immediate considerations, he may be willing to pay more than 75% of reproduction cost for an old building one-fourth depreciated rather than build a new one.

Property Not Being Used as Originally Intended.

In the foregoing discussion, the main point advanced has been that a building is worth its cost to reproduce less depreciation, provided it is the proper improvement for the location or is an efficient unit of a well designed and well managed plant. If it were not for the fact that a building or even a whole plant could be reproduced physically, its value might increase in proportion to its earning power. Cost to reproduce less depreciation is, therefore, the upward limit to the value of a building or other fixed asset, and for that matter any asset. The lower limit is of course a negative value, the cost to remove it from the land upon which it stands.

There is a class of property the value of which falls somewhere between these two limits, namely, buildings, structures, machinery, and other equipment that are not at the time of valuation as efficient as other property of its kind. Such property may have been ill advised, may be in a poor location, may be poorly managed, may be used for a purpose other than that for which intended. There are many examples of this kind of property. Houses may be in a poor residential section, which was originally an exclusive one. Brewery plants, whose product was outlawed by the Federal government, may now be used as rooming houses, and manufacturing plants may have poor management and consequently less value.

There is no such thing as "intrinsic value" in the economic sense. If a building or plant produces no products or services, or if the products or services it produces cannot be disposed of at a price which more than covers all other costs, it is worth nothing. The services and products yielded by a building or plant may be in demand and have a value in exchange. The sale of

such services and products might yield a rent over and above all other costs, including the enterprises' profit. If the building or plant yields such a rent, it has a value. Would it not be feasible to measure its value by the size and permanency of the rent yielded?[1] The rent yielded could be capitalized on a basis to conform with the experience of other businesses of the same kind.[2]

The valuation of property in fire loss adjustments has its own peculiar problems. The determination of the quantity and quality of property covered by the policy and of the property destroyed by the fire is complicated by the fact that the property itself has been damaged or destroyed. The evidence upon which to base a valuation does not exist in many cases. Success in gathering the data tending to prove the value depends in great part upon the insured. In the present chapter it is assumed that the evidence is available.

The problem of depreciation has a special angle in fire loss adjustment in view of the fact that the restoration of the claimant to his previous condition is contemplated by the policy and must be kept in mind. In adjusting partial losses, repair and replacement are prime considerations. With the property of a profitable going concern, cost of reproduction less depreciation is the basis of valuation. The problem of obsolescence is especially vital in the valuation of property that is not being profitably used or is not being used for the purpose originally intended. Where a property is not worth its cost to replace less physical depreciation, the adjuster must be especially careful to get all per-

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[1] See John A. Zangerle, Op. Cit., p. 59 for a discussion of Appraisals based on earnings.

[2] "The real basis of value, however, which generally guides a purchaser, is the estimated earning power, or the net revenue, past, present, and prospective, so far as can be ascertained." Matheson, quoted in H. A. Foster, Engineering Valuation of Public Utilities and Factories, D. Van Nostrand Co., New York, 1913, p. 7. "The value of property, generally speaking, is determined by its productiveness,—the profits which its use brings the owner. Various elements enter into this matter of value....Neighborhood to centers of business and population.....Demand for use.....number and amount of such uses.....The value, therefore, is not determined by the mere cost of construction, but more by what the completed structure brings in the way of earnings to its owner." Monongahela Navigation Co. vs. United States, 13 Sup. C. 627.

tinent facts regarding management, earnings, etc. A valuation on the basis of capitalized earning power may be advisable, at least as a test of the valuation on some other basis. The importance of the human element in plant and property values cannot be overemphasized. It is especially important in valuing property in plants or units which are ill-advised or obsolete.

The problems of valuation in loss adjustment are not insurmountable. The knowledge and skill necessary to ascertain the "actual cash value" of most property destroyed by fire is available to the adjusters. If loss settlements are made at figures above or below "actual value" in many cases, it is not because of the valuation problems. The adjuster and the claimant together are in nearly every case able to value the loss quite accurately, if both are willing.

CHAPTER V.

STATUTES AND DECISIONS AFFECTING APPRAISALS

The Policy Contract

Some of the general problems confronting the adjuster as an appraiser were considered in the previous chapter. These problems may be solved in most cases by following the established principles of valuation. These principles may be applied by the adjuster himself or by experts employed by him. In either case, the personal skill and judgment of the appraiser are of the utmost importance. But it is not enough that the adjuster be able to determine accurately the values of various kinds of property involved. He also must properly interpret the policy contract and the statutes and court decisions of the state in which he is operating. The statutes and court decisions of the several states differ from each other so much that a statement of general principles may only serve to confuse the adjuster, unless he is thoroughly familiar with local practice. The question of cash value, which is central to all matters of appraisal, is one concerning which there is apt to be a lack of uniformity. The language of the insuring clause in the standard form of the fire policy is apparently not ambiguous, but the interpretation of it has given rise to much confusion.

Provisions in the Policy Limiting the Amount Payable.

The policy not only specifies that the amount payable is limited to the "actual cash value" of the property destroyed but also provides certain other limits. These limits presumably are options which the company may elect in case an agreement as to the amount payable to the insured cannot be reached. At any rate they serve to protect the company against the possibility of being forced to pay more than "actual cash value." Reference to the

clauses quoted above will disclose the exact nature of these limitations. These limitations become operative only in case the "actual cash value," as determined at the date of the fire, exceeds one or the other of them.

The Face of the Policy.

Unless expressly agreed by the parties to the policy contract, or unless the state law prescribes,[1] the amount stated in the policy is merely the extreme limit of recovery and is not a proper measure of loss.[2] As a matter of fact the amount stated as the value of the property in the application for insurance under the ordinary fire policy is not evidence of its value at the time the loss occurs.[3]

The parties to the fire insurance contract are, however, permitted to agree upon the value of the property covered at the time the insurance policy is written. A policy of this nature is termed a valued policy and is used quite commonly in insuring articles whose value might be difficult of determination in case of a fire loss. Under a valued policy and in the absence of fraud or intent to evade the law, the value stated in the policy is conclusive evidence of the amount of the loss, even though other evidence be submitted showing that the value specified was erroneous at the time the contract was entered into and was far from correct at the time the loss occurred.[4] Under a valued policy, in case of a total loss, the insurer is ordinarily required to pay the amount stated in the policy less depreciation from the date of the policy to the date of the loss.[5]

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[1] The valued Policy laws are discussed in this chapter below.

[2] Clement, Fire Insurance as a valid contract, I, 17, 2. Richards on Insurance Law, 1921, p. 30. 26 Corpus Juris 354.

[3] 26 Corpus Juris 354.

[4] 171 N. Y., 25; 101 N. Y. 458; 43 Wis. 449; 42 Neb. 537; Richards on Insurance Law, 1921, p.——; 106 Pa. St. 20; 48 Pa. St. 367; 124 Mass. 126; 24 Fed. 767.

[5] 26 Corpus Juris 354; 193 Mo. App. 187; 278 S.W. 772.

In a suit by a sugar company in Cuba against the Knickerbocker Insurance Company of New York, it was held that a fire insurance policy covering growing sugar cane which contained a typewritten rider providing a definite method of ascertaining the amount of loss in the event of fire was a valued policy.[1] The rule may be established, therefore, that where the policy shows the intention of the parties to agree beforehand to estimate the value of the subject of insurance, this valuation is conclusive, and the policy to that extent modifies the principle that the contract is one of indemity.[2] It may be stated that only in case of agreement between the parties or in states having valued policy laws does the amount stated in the policy have a bearing on the settlement of a loss unless the actual cash value of the property destroyed is as great as this amount. This limitation may become effective with respect to a given portion of the loss in case the insurance is itemized, the limit of recovery for each item being the amount of insurance placed on it. Again in the case of more than one loss occurring under the policy during the pendancy of the risk, the total amount recovered on all losses is limited to the face of the policy.[3]

Not Exceeding Amount it Would Cost to Repair or Replace.

As in the case of the clause limiting the loss to the face of the policy, which has just been discussed, the stipulation in the policy that the loss or damage shall not exceed "the amount which it would cost to repair or replace the same with material of like kind and quality within a reasonable time after such loss or damage," and the clause giving the insurer the option, "to repair, rebuild, or replace the property lost or damaged with other of like kind and quality, within a reasonable time," are, in the absence of agreement or special law, to be treated as limitations only and

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[1] 16 Fed. (2nd) 127.

[2] 171 N.Y. 25; 71 N.Y. Supp. 918; 5 Johns. 368; 24 Fed. Rep. 767; 5 Miss. 63; 12 Mass. 71; 124 Mass. 126; 8 Johns 229; 48 Ps. St. 367; 106 Ps. St. 20; 4 La. Ann. 289.

[3] 149 Ill. 298.

not as means of measuring the amount of the loss.[1] In ascertaining the amount of the loss payable under the policy, these stipulations are not to have effect unless the actual cash value of the loss exceeds the cost to repair or replace. But in that event the cost to repair or replace and not the difference between the cash value before and after the fire or market value or any other value is the measure of indemnity.[2] These clauses are often followed in fixing the amount payable in case of partial loss.

This principle was clearly stated in the case of the Standard Sewing Machine Co. vs. The Royal Insurance Company.[3] In that case the lower court held that the market value of the machines destroyed was the measure of damages, and a verdict of $1,727 per machine, the established market value according to the evidence, was rendered. The higher court held that, since the evidence also showed that it would have cost the insured only $1,283.93 each to restore or replace these machines as they were at the time of the fire, and, since the policy specified that the actual cash value of the property destroyed was not to be the measure of damages in case it exceeded what it would cost to repaid or replace it, the verdict had to be amended. The insured was, therefore, allowed to recover only what it would cost him, a manufacturer, to replace the property destroyed.

If, however, the property is of such a nature that it cannot be replaced within a reasonable time, its actual cash value or its market value may be recovered even though the cost to repair or replace is less.[4] Great stress seems to be put on the word "then," in the construction of this clause and on the reasonableness of the provision under the circumstances. In the case of a loss of lum-

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[1] Clement.; 26 Corpus Juris 448, par. 601; Commonwealth Insurance Co. vs. Sennett, Baer & Co., 37 Penna. 208. This provision of the policy seems to have been introduced to protect the insurer against increases in real estate values which are independent of costs of construction. 86 Vt. 267.

[2] Clement.

[3] 201 Pa. St. 645.

[4] Thus in the case of a manufacturer of straw hats, market value was allowed because they could not be replaced in time for the current season's trade. 112 N.Y. Supp. 769.

ber manufacturer,[1] it was held that the insured could recover the market value at the date of the fire of the lumber destroyed, even though the insured was a manufacturer of lumber and owned timberland. The reason stated being that it would require some time to cut and haul the logs, saw and pile the lumber in the yard, and that, therefore, no distinction should be made between the dealer who owned his own mill and the one who did not. It has also been held that a manufacturer in recovering for the loss of finished goods, is not limited to the cost of the raw materials, labor and supplies used in its manufacture. He may recover the actual cash market value of the goods at the time of the fire even if a profit results.[2] This clause is to be considered as a limiting factor only and is operative if the property can be repaired, or replaced within a reasonable time.

The further qualifications of the replacement and repair clause by the insertion of the words, "without allowance for any increased cost of repair or reconstruction by reason of any ordinance or law regulating construction or repair," was brought about by adverse decisions holding that the measure of loss was limited by the cost to rebuild or repair in compliance with the building laws and regulations.[3] The old rule still holds unless such increase in the cost of replacing or repairing is excluded by terms of the policy.[4] Needless to say, most policies now contain the above qualification excluding the increase in building costs. The clause limiting the loss to the cost of repairing or replacing is not rendered inoperative as the measure of loss in case the building cannot be restored because of a local law prohibiting erection or alteration unless fireproof.[5] A decision rendered by a Federal Court, however, seems to indicate that an insurance company is

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[1] Hartford Insurance Co. vs. Cannon, 19 Tex. Civ. App. 305. See also Mitchell vs. St. Paul German Fire Ins. Co., 92 Mich. 594.

[2] Mechanics Ins. Co. vs. C.C. Hoover Distilling Co. 182 Fed. 59. See also Frick v. United Firemen's Insurance Co., 218 Pa. 409. It was reasoned that the process of manufacture consumed considerable time consequently a profit was justified.

[3] Penna. Co. vs. Phila. Contributorship, 201 Pa. 494, 497.

[4] 26 Cropus Juris, 354; 184 Mass. 177.

[5] McCready vs. Hartford Insurance Co., 61 App. Div. (N.Y.) 583.

liable for a total loss if a building is rendered incapable of repair under a building code.[1]

Interruption of Business.

The policy specifically excludes loss resulting because of any interruption of business and confines the loss to that resulting from the destruction of existing values. All remote damages are excluded unless specifically covered in the policy.[2] Loss resulting from the interruption of business operations may be covered in a special policy, however.

"Actual Cash Value" Under the Law

Fixed Property.

With the exception of the special cases just considered, which arise out of the limitations specified by the policy contract and local and state laws, the amount payable in the case of a loss by fire is the "actual cash value (ascertained with proper deductions for depreciation) of the property at the time of the loss or damage."

The only question remaining to be considered is how the courts arrive at the "actual cash value" of property destroyed by a fire. In conformity with the principles of valuation taken up in the last chapter, different methods of valuation have been used by the courts in arriving at the value of fixed and moveable property destroyed by fire.[3] As stated by the court in an early case, "counsel seem to have confounded the measure or rule of damage for merchandise or goods destroyed with that for building."[4]

The rule or measure of "actual cash value" of a building is its value as it stood upon the ground on the day it was destroyed as compared with a new building of the same kind and dimensions.[5]

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[1] Rutherford vs. Royal Insurance Co., 1926, 12 Fed. (2nd) 880.
[2] 92 Mich. 594; 110 La. 1019; 96 Tenn. 193; Richards on Insurance Law, p. 296.
[3] 256 Pacific 522.
[4] State Ins. Co. v. Taylor, 14 Colo. 499.
[5] 11 Bush (Ky.) 587; 92 Me. 272.

The "intrinsic value" of the property destroyed to the owner[1] at the time of the fire is the proper measure of damages. In arriving at that value various tests have been permitted by the courts. The sum necessary to erect a new building would in most cases be a much larger sum than the insured is entitled to recover.[2] The cost of replacement would, therefore, not be the proper rule to follow.[3] But it is entirely permissible to consider the cost of constructing a like building at the time of the fire on the same land, together with the depreciation that has taken place because of age and use, in arriving at a just conclusion as to the loss sustained.[4] In a very recent case coming before the Supreme Court of the state of Idaho, the principle was definitely laid down that the measure of loss, in the case of a building, is the cost of a new building of the same materials and dimensions as the one destroyed, less the amount the destroyed building had depreciated by use.[5]

The difficulty of laying down exact rules is recognized by the courts, in view of the fact that the same kind of evidence is not always available. It is necessary, however, to find some concrete means of measuring the value of the property destroyed, and so various measures are used. In one case the original cost, $8,061.00, was increased by 20% because of increased prices of building material and labor and then decreased by 10% for depreciation, and the loss settled for $8,500.00.[6] It is entirely permissible to consider original cost together with depreciation in determining the value of property destroyed.[7]

Regardless of the method employed, the burden of proof as to the extent of the depreciation rests on the insurer.[8] The prin-

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[1] 110 La. 1019. ("Intrinsic Value" is not a scientific term.)
[2] 11 Bush (Ky.) 587; 110 La. 1019; 186 Ill. A. 565.
[3] 14 Colo. 499; 192 Pa. St. 359; 98 Iowa 67.
[4] Ibid.
[5] 256 Pacific 522, 1927. See also 219 Ill. App. 506.
[6] 110 La. 1019.
[7] 14 Colo. 499; 98 Iowa 67.
[8] 11 Fed. 485; 98 Iowa 606; 80 Ala. 571; 103 Iowa 307; 72 Cal. 535.

ciple of depreciation is recognized in all cases, however, and only its amount needs to be proved.[1] The first of the two methods above enumerated is preferred by the courts, and the second seems to be resorted to only if evidence of the present construction cost or of changes in construction costs has not been introduced. It has been held, that obsolescence should also be considered.[2]

Obsolescence is a cause of depreciation and as such should be given proper weight in valuation. Evidence tending to establish the extent of depreciation due to obsolescence must be admitted. This principle is supported by a case in which the owner of buildings formerly used as a brewery brought an action for recovery for a loss by fire. The buildings had been rendered useless by the enactment of the National Prohibition Act. It was held that, in determining the extent of depreciation, the effect on their value of the passage of the Prohibition Act and the adaptability or inadaptability of such buildings to other commercial purposes would have to be considered. A contention advanced by the plaintiff, that the sole measure of damages under such policy was the cost of reproduction less physical depreciation, was held to be untenable.[3] Buildings usable for commercial purposes and those usable as family residence should not be valued in the same way. Handsomely carved woodwork or other ornamental features in a residence might be held to have insurable value, whereas, if found in a factory they would have no use for factory purposes and would have no value. Factory buildings peculiarly adapted to the manufacture of a given product must have depreciated in value when that product may no longer be manufactured. Buildings useful only for factory purposes have lost value when no longer used or usable for such purposes. In all the cases consulted, the principle is firmly established that the actual cash value

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[1] 98 Iowa 67.

[2] 159 N.E. 902.

[3] 159 N.E. 902

of fixed property is in no instance its market value[1] or what someone would have paid before the loss. Many reasons have been advanced in support of this principle. Among them are the following:

a. The market value as determined by an auction sale is commonly known to be less than real value.[2]

b. The land may not be marketable at all, and, in that case, the building would be practically unmarketable, or would have a low market price.

c. Fixed property is attached to the land and for that reason its market value depends too much on the value of the land.

d. Fixed property cannot readily be converted to another use.

It is not proper to take the difference in value of the lot with the building on it and its value after the building has been destroyed, since it is entirely possible that, because of the character of the building or because of the suitability of the lot for building purposes, the lot alone will sell for as much as the lot with the building on it.[3]

The principles laid down by courts for the valuation of fixed property may be summarized as follows:

The cost, at the time of the fire, of labor and materials necessary to construct an identical property on the same land, less the depreciation on it from the time it was built to the time of the fire. In determining the cost of labor and materials and also in determining the amount of depreciation, builders, engineers and other

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[1] 256 Pacific 522; 219 Ill. App. 506; 11 Bush (Ky.) 587. The reasoning of the judge in the case of McAnauney vs. Newark Fire Insurance Co., et al., 159 N.E. 902, was somewhat as follows: The market value of the buildings destroyed is not the exclusive measure of value. Market value is applicable only in the case of articles which may be replaced with a substitute identical in kind and quality. However, the rule presupposes the existence of a broad market with frequent trading in articles of an identical character. Value does not inhere in the thing to be valued. It is a subjective concept. Identity of belief on the part of many traders as indicated in a market causes the conception to assume the objective quality of an established fact. Proof of a single sale or the opinion of an expert does not establish market value. (This reasoning supports the discussion of valuation in the last chapter.)

[2] 110 La. 1019.

[3] 11 Bush (Ky.) 587; 110 La. 1019.

witnesses may be called. Every fact and circumstance which would logically tend to the formation of a correct estimate of the loss should be presented to the jury. Such facts may include: Original cost, cost of reproduction, opinions of qualified witnesses, declarations of the assured, gainful uses to which buildings might have been put, the extent of depreciation, which includes obsolescence, etc.[1]

Moveable Property.

In determining the cash value of moveable property destroyed by fire, the courts distinguish beween merchandise held for sale; and furniture, fixtures and personal effects held for use. A long list of cases lays down the principle that the market value of merchandise is the measure of recovery in all cases where the property can be said to have a market value.[2] In a case where a quantity of oil was destroyed, the market price of 75c fixed by the state was declared to be the measure of recovery. In valuing some of the oil, the cost of piping 500 miles was added to the market price at the point of manufacture.[3] The market value, however, must be taken as at the time the loss actually occurred.[4] In the case of a loss by fire of a large quantity of cotton in Brooklyn, it was held that the cotton exchange price on the day of the fire and not on the day previous to the fire was the measure of loss, even though the impending loss of such a large quantity of cotton drove the price up before the cotton was actually destroyed.[5]It is not the time that the fire starts that is important, but the time the destruction of values takes place.

The cost of manufacturing merchandise is not the measure of cash value if the manufacturing process requires any considerable time and if there is an established market.[6] Two cases, one involving a loss of whiskey and the other a loss of lumber, estab-

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[1] 159 N.E. 902.
[2] 256 Pacific 522; 284 Fed. 452; 33 Fed. 544; 19 Tex. Civ. App. 305.
[3] 248 Fed. 452.
[4] 170 Fed. 179; 160 La. 275; 39 Tex. Civ. App. 168.
[5] 170 Fed. 179.
[6] 218 Pa. 409; 182 Fed. 590; 92 Mich. 594.

lish this principle. The manufacturer's profit in merchandise lost by fire is covered under a fire insurance contract. This profit is the difference between the cost to replace in the market and the cost to manufacture. There must, however, be a ready market for the goods. Market value is held to be the value in the market available to the insured if he contemplated replacing the property lost and not necessarily the market in which he ordinarily sells his merchandise. The reasoning involved is that replacement of the property in kind would be complete indemnity, consequently, the market price to replace the property lost by the insured is the true measure of value.[1] Trade discounts and cash discounts customarily allowed the insured are deductible in determining the "actual cash value."

Where the price of a product in one stage of manufacture can be shown to bear a definite relation to the price of the finished product, the market price of the finished product may be used as a basis for determining the cash value of the property destroyed.[2] The great difficulty of determining the value of goods in process of manufacture can in this manner be eliminated. If no established market for the finished product exists, the cost to the manufacturer may be a fair measure of value.

Where there is a question as to the quantity of merchandise destroyed, because complete books and records are not available, evidence of the amount shown by a prior inventory, together with purchases and sales since may be introduced to prove the quantity. Even the amount of deposits made in a bank or the amount of unpaid accounts and notes may be used.[3]

When there is no established market for the merchandise destroyed, the task of determining the cash value of the property destroyed is somewhat more difficult. The cash value is then determined by considering the character and quality of the goods, the quantity, the cost, the change in prices since purchase, proof of subsequent purchase, the condition of the goods and all other evidence submitted. The reasonable market or intrinsic value

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[1] 159 N.E., 902.
[2] 160 La. 275.
[3] 26 Corpus Juris, 533, 534.

will be the actual cash value.[1] The term "intrinsic value" is used often in court decisions. It is, however, an indefinite term without a clearly defined meaning.[2]

When furniture, fixtures and personal effects, that have been used to some extent by the owner, are damaged, the actual cash value, as that of merchandise, is what it would bring in a fair market after a reasonable attempt to find a purchaser who will give the highest price.[3] The difficulty is that there is no established market for property of this kind. The problem is not quite the same as that of fixed property, since the property may be moved to a market some distance away. If the property can be sold to better advantage at a distance, then the price it would have brought there less cost of transportation is the "actual cash value" of the loss.[4]

If a fair market value cannot be established due to the fact that the property would not have been salable except through second-hand dealers, the value of it to the owner should be taken.[5] This value may be established by considering the cost of the property when new, the extent of depreciation in its used condition, its value to the owner for the use to which it was put, and the condition it was in at the time of the loss.[6] Sentimental value to the owner is not to be considered. The fact that the property destroyed was received as a gift, or was purchased at small cost is of no importance in determining the amount of the loss.[7]

Conclusions

There are very few important discrepancies between the established principles of valuation and the opinions of courts as expressed in fire loss cases. The valuation clauses in the standard

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[1] 26 Corpus Juris, 536; 4 Fed. 59.
[2] 159 N. E. 902.
[3] 221 Fed. 931.
[4] 221 Fed. 931.
[5] The law of damages distinguishes between marketable goods possessed for sale and for use. Value of former measured by market price, value of latter not by value in second hand market but by the value of their use to the owner who suffers their loss. (159 N.E. 902.)
[6] 256 Pacific 522; 37 Neb. 184.
[7] 89 Wis. 572.

policy also conform to standard business practice. The purpose of the limiting clauses is to protect the company and to aid in reaching an agreement with the claimant and not to defeat any recognized principles. Even valued policies are used for the same purpose, namely, to place a value or to provide a means for placing a value on property that it would be impossible to value by any other means.

The various courts of law, at least the higher courts, seem to be fairly well agreed upon the principles to be followed in adjusting losses. Most of the uncertainty involved in bringing a given case to court arises because of the use of a jury to establish the facts. The average juror is not an expert in valuing property in good condition, and ordinarily has had no experience with partly damaged property. Furthermore, the average juror is apt to be prejudiced against the company at the outset. Companies cannot, therefore, be blamed for attempting to settle cases out of court.

Local laws or ordinances, the policy of courts having immediate jurisdiction, and special clauses in the policies of a given claimant should all be familiar to the adjuster before he undertakes a given adjustment. With the exception of "Valued Policy Laws" they place no serious obstacles in the way of a satisfactory settlement with the insured. These "Valued Policy Laws" will be considered now.

Valued Policies and Indemnity

In the first part of the chapter, the laws and court decisions governing the application of policy provisions in adjusting losses were discussed. This discussion was limited to those cases in which the sound value of the property involved as well as the value of the damage is to be determined after the fire occurs. It now becomes necessary to take up the question of the effect of valued policies on loss adjustment. The "Standard Policy" ordinarily is not a valued policy. However, many states have laws on their statute books making any policy a valued policy in certain instances, and any policy may be made a valued policy by the attachment thereto of a rider specifying the value or the procedure to be followed in determining the value of the property

in case of loss. Thus, valued policies arise out of special state laws and out of agreements endorsed upon the policies.

In twenty-four of the states, so called valued policy laws are in force.[1] In general, these laws provide that, whenever an insured building is totally destroyed by fire, the amount of insurance in force should be taken as conclusive evidence of the value of the property, and the amount of the loss, regardless of the actual cash value of the property at the time of the fire.[2]

Indemnity the Object of Loss Adjustment.

Courts of law have repeatedly held that the purpose of a fire loss settlement is to carry out the terms of the policy, which means to indemnify the insured (a person) for loss or damage to his property (a thing).[3] The sole object of a loss adjustment is to indemnify or reinstate the owner for loss or damage actually suffered in such a manner that he shall not have actually profited because of the fire nor shall he have suffered a loss unless his insurance has been inadequate or unless from an event not insured against.[4] The general principle in loss settlements is that, so far as is possible under the terms of the contract the insured shall be fully indemnified for actual loss sustained according to his interest, but that he shall not be more fully indemnified.[5] In other words, the policy guarantees, "indemnity to the insured, commensurate with his insurable interest as existing at the time of the loss."[6] The insured is ordinarily entitled to be put in the same condition pecuniarly as he would have been in had there been no fire.[7] While exception can be found where the principle of in-

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[1] The Insurance Almanac and Encyclopedia, Op. Cit., 1929, p. 1043.

[2] The Philosophy of Fire Insurance, A. F. Dean, Vol. 1, p. 111.

[3] Sadlers Co. vs. Babcock (2 Atk. 554). May on Insurance (I.1.p.4). The True Purpose of the Loss Settlement, Allen E. Clough, The Fire Insurance Contract, p. 275, Insurance Society of New York, 1920.

[4] Property Insurance, 1926, Dr. S. S. Huebner, p. 17. Richards on Insurance Law, 1921, p. 27.

[5] Welford & Otter—Barry's Fire Insurance, England. Columbia Insurance Co. vs. Lawrence, 10 Pet. 507. Carpenter vs. Providence-Washington Ins. Co. 16 Pet. 495.

[6] 68 Ga. 669.

[7] 23 Fla. 193; 67 Ill. 362; 11 Ill. A. 242; 185 Mass. 419; 225 N. Y. 53; 1 N.Y. Super. 41; 98 Pa. 451; 57 N.W. 409; 10 Tex. Civ. A. 398; 74 W. Va. 344.

demnity does not seem to have been followed,[1] it is the opinion of leading writers on insurance law that our courts have since the earliest days followed the principle of indemnity in settling fire loss cases, and that there is a tendency to set aside mere technicalities to the ends that justice and sound public policy may prevail.[2]

It has been held by some that the doctrine of indemnity cannot be observed in settling a loss under a valued policy.[3] It has been claimed by others that valued policy laws do not oppose the principle of indemnity but merely introduce a means of valuation in cases where the destruction of the property by fire means the destruction of all evidence of value.[4] The United States Supreme Court has decided that the valued policy law of the State of Missouri does not violate the principle of indemnity.[5] The Missouri law provided that, at the time of insurance, the property was to be considered as worth the full amount insured. In case of a total loss by fire, the measure of damage was to be the amount for which the property was insured less depreciation from the time the insurance was placed to the time of the fire. The burden of proving depreciation however, rested upon the company.[6] In deciding that the doctrine of indemnity was not violated, the court said, "The statute tends to assure, not to detract from the

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[1] 152 N.Y. 131; 171 N.Y. 25; 58 Miss. 441; affirmed by Court of Appeals in 199 N.Y. 550; The True Purpose of the Loss Settlement, Allen E. Clough, The Fire Insurance Contract, 1920, p. 282, Insurance Society of N.Y.

[2] Clement, Fire Insurance as a Valid Contract, I, 17.; May on Insurance, I, 1, 11.; Cooley, Briefs on the Law of Insurance, I, 85-97; Richards on Insurance Law, 27, 72; Ostrander, Law of Fire Insurance, 356; 90 Tenn. 306, 347; 16 Pet. 495; 14 Pick (Mass.) 141, 146; 55 N.H. 458; 151 U.S. 452; 31, Ill, App. 295; 132 Ill. 522; 2 N.Y. 210; 132 N.Y. 133; 18 Pick (Mass.) 523; II Q.B. Div. 380; 139 U.S. 79, 88; 3 La. 366; 1 La. Ann. 216; 67 Ill. 362; 91 Atl. 206; 2 Wend (N.Y.) 280; 90 Tenn. 604; 18 S.W. 260; 67 Vt. 14; 30 Atl. 798; The True Purpose of the Loss Settlement, by Allen E. Clough, The Fire Insurance Contract, 1920, p. 275, the Insurance Soc. of New York.

[3] 94 Atl. 642; 91 Atl. 206.

[4] 35 Mo. App. 308; Richards on Insurance Law, 1921, p. 31.

[5] 172 U.S. 557, Dec. 16, 1899.

[6] Ibid.

indemnity of the contracts.....The change is from one kind of indemnity policy to another kind,....."[1]

Since the law permits the subsequent depreciation of the property to be shown, additional risk to the company can result only from fraud or from carelessness.

"Risk then can only come from the failure to observe care—that care which it might be supposed, without any prompting from the law, underwriters would observe, and which, if observed, would make their policies true contracts of insurance, not seemingly so, but really so; not only when premiums are paid, but when loss is to be paid."[2] Whether the use of a valued policy is contrary to the principle of indemnity or not, it introduces an adjustment problem that must be settled.

The Reason for Valued Policy Legislation.

A valued policy law was first passed by the state of Wisconsin in 1874.[3] The original purpose of this law was to prevent over-insurance.[4] The origin of the idea of the valued policy laws is not known.[5] They may have been patterned after foreign customs.[6] The people of Wisconsin were largely farmers, and many of them were familiar with the practice in Europe of having city or state surveyors value property insured. In the early seventies there was bitter hostility toward insurance companies, in Wisconsin. This hostility was due in part to the activities of a few irresponsible companies.[7] Policies were sold as a side line by pedlers, who were interested in the size of their commissions. No limitation was placed upon the amounts written, but, when losses occurred, shrewd adjusters called attention to artfully phrased policy conditions and scaled down the loss payments to

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[1] Ibid.
[2] Ibid.
[3] Harry Charles Brearley, Op. Cit., p. 275, 276.
[4] Ibid.
[5] In 1744, valued policies, i.e. policies under which the whole amount insured was paid without question upon the destruction of the property, were being issued in Holland. The Insurance Cyclopaedia, The Spectator Co., Chicago, 1874, Vol. III, p. 557.
[6] Harry Chase Brearley, Op. Cit., p. 275, 276.
[7] Harry Chase Brearley, Op. Cit., p. 276.

suit their companies. The use of technicalities to defeat the policies, the unwarranted reduction of claims by taking advantage of claimants and the acceptance of premiums for insurance in excess of property values have been held responsible for the enactment of valued policy laws in many states. The laws were intended originally to force companies to use greater care in underwriting.

The Spread of Valued Policy Legislation.

Following the lead of Wisconsin, other states passed valued policy laws. Ohio and Texas each passed such a law in 1879, New Hampshire in 1885, and Arkansas, Delaware, Missouri and Nebraska in 1889.[1] Following 1890 there was a veritable avalanche of valued policy laws. Between 1891 and 1900 inclusive, no fewer than one-hundred-sixty-eight such measures were introduced into the legislatures of the various states.[2] However, during this period, laws were actually passed in only eleven states, namely, Oregon, Kansas and Kentucky in 1893, Georgia in 1895, South Carolina and Rhode Island in 1896, Washington, Iowa and Florida in 1897, West Virginia in 1899 and Louisana in 1900.[3] Other states later passed valued policy laws as follows: Colorado in 1901, Mississippi in 1902, South Dakota in 1903, Minnesota in 1905, North Dakota in 1907 and Tennessee in 1909.[4] As recent as 1915, valued policy bills were considered by the legislatures of Indiana, Massachusetts, Montana, Nebraska, New Mexico and Oklahoma.[5] None of them were enacted into laws, however.

Throughout the entire period of valued policy legislation, there was much agitation for as well as against these laws. In many cases the laws were repealed, reenacted or changed.[6] Even the

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[1] Annual Cyclopedia of Insurance in the United States, The Index Publishing Company, New York, 1929, p. 191. Elliott, Charles N., A Treatise on the Law of Insurance, The Bobbs-Merrill Co., Indianapolis, 1907, p. 364.

[2] Harry Chase Brearley, Op. Cit., p. 278.

[3] Annual Cyclopedia of Insurance, Op. Cit., p. 191, Elliott, Charles B., Op. Cit.

[4] Ibid.

[5] Harry Chase Brearley, Op. Cit., p. 279.

[6] Annual Cyclopedia of Insurance, Op. Cit., p. 278.

State of Wisconsin repealed its law in 1915 and enacted a substitute, forbidding the placing of insurance or the paying of losses in excess of actual cash value.[1]

Objections to Valued Policy Laws.

The opposition to valued policy legislation has from the first been very pronounced. In 1893, Governor Pattison of the State of Pennsylvania vetoed a valued policy bill because he believed it to be contrary to the principle of indemnity.[2] He stated that over-insurance and over-valuation, which are encouraged by valued policy laws, are conducive to fraud, perjury and arson.[3] In the same year, Governor Altgeld of the State of Illinois, vetoed a similar law.[4] He claimed such a law would prove a blessing to dishonest men. In 1899, Governor Thomas of Colorado, in vetoing a valued policy bill, stated that in all states having similar legislation, the proportion of fires increased, presumably because of incendiarism. He further stated that valued policy laws are vicious and cannot be defended from any standpoint.[5] The following objections were made by Governor Atkinson of West Virginia in the same year:[6]

1. The valued policy law is against public policy.

2. Since it applies only to real estate, it is class legislation.

3. It requires the adjustment of a loss by an insurance company before any loss occurs, an inconsistent, unreasonable and expensive method.

4. Such legislation has not proved satisfactory in other states. In 1900 Governor Shaw of Iowa made a personal investigation in Southern Iowa and Northern Missouri, and concluded that the valued policy law increases the hazard.[7] He held that nothing in excess of actual loss should ever be collectible, and that the in-

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[1] Harry Chase Brearley, Op. Cit., p. 278.
[2] A. F. Dean, The Philosophy of Fire Insurance, Edward B. Hatch, Chicago, 1925, Vol. 1. p. 159-165.
[3] Ibid.
[4] Ibid.
[5] Ibid.
[6] Ibid.
[7] Ibid.

sured must be a coinsurer to induce him to prevent fire and loss. Another objection he had to the law was the difficulty of examining property to determine its value. Because of the commission system of reimbursing agents and brokers, he believed it was very difficult to prevent over-insurance.[1]

Analysis of Valued Policy Laws.

The objections that have been raised against valued policy legislation have not all been directed against the same type of bill. Some of these laws are less objectionable than others. In view of this, an analysis of present valued policy laws seems desirable. While most valued policy laws originally were modeled after that of the state of Wisconsin, no two are exactly alike today. Variations have been introduced because of opposition to specific features and because of variation in court decisions.[2]

The valued policy laws of Delaware, Florida, Kansas, Kentucky, Minnesota, Mississippi, Missouri, Nebraska, New Hampshire, North Dakota, Ohio, Oregon, South Carolina, South Dakota, Tennessee, Washington and Wisconsin either impliedly or specifically require the valuation of the property to be fixed at the time the insurance is effected. The amount of insurance written in the policy is to be taken as conclusive evidence of the true value of the property at the time the insurance is negotiated and, excepting the laws of Missouri and Kentucky, the true amount and measure of damages in the event of a fire.[3] The laws of Missouri and Kentucky permit the insurer to prove the fact and amount of depreciation from the time the policy was written to the time of the fire. The laws of Arkansas and Texas provide that the face of the policy shall become a liquidated demand against the insurer in the event of a total loss by fire.[4] The law of Iowa provides that the amount stated in the policy shall be prima facie evidence of the value of the property at the time the

[1] Ibid.
[2] A brief summary of the valued policy laws in effect in 1928 will be found in Sunderlin on Insurance, the Spectator Company, 1928, Lecture VII, p. 25.
[3] Ibid.
[4] Ibid.

insurance is written, but permits the insurer to prove actual value at that date and any depreciation to the date of the fire.[1] The law of Oklahoma provides that the actual cash value shall be established at the time of the loss, but that any premiums paid on an amount in excess of that value shall be returned.[2] The California law provides that, if there is no valuation in the policy, the measure of indemnity is the expense to the insured to restore the property lost or damaged to the condition it was in just prior to the fire, [3] but that the insured may require the property to be valued at the time the insurance is written.[4] The law of Georgia states that the measure of damages is actual cash value.[5]

Most of the valued policy laws apply only in case of a total loss.[6] The laws of Florida, Missouri, South Carolina, South Dakota and West Virginia, however, provide that in case of a partial loss the amount payable shall be determined by the proportionate relationship of the property destroyed to the whole property valued in the policy.[7] Furthermore, many of the laws operate only in the case of real property. The laws of Arkansas, Iowa, Kansas, New Hampshire, Oklahoma, Oregon, Tennessee, Texas, West Virginia and Wisconsin specifically exclude personal property.[8]

The most objectionable laws are those which rigidly fix the value of the property and the amount payable at the amount stated in the policy. Changing construction costs and depreciation should be taken into consideration in valuing property at the time of the fire. The laws of Missouri, Kentucky, and Iowa recognize that depreciation should be considered. The California and Georgia laws are not valued policy laws in the true sense, because they provide that the actual cash value of the property destroyed shall be paid unless there is an express agree-

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[1] Ibid.
[2] Ibid.
[3] Ibid.
[4] Annual Cyclopedia of Insurance, Op. Cit., p. 191.
[5] Sunderlin on Insurance, Op. Cit.
[6] Richards on Insurance law, 1921, p. 695.
[7] Sunderlin on Insurance, Op. Cit.
[8] Ibid; Wisconsin, Insurance Laws, 1927, Milton A. Freedy, Insurance Commissioner, p. 106; Insurance Laws State of Texas, 1927, R. B. Coosins, Ir., p. 95; Insurance Laws of State of West Virginia, 1927, p. 44.

ment to the contrary in the policy. The law of Iowa seems to be the most reasonable and just, since it permits the insurer to prove a change in values as well as depreciation. It is not scientific to determine the value of the property at the time of the fire solely on the basis of the value stated in the policy. Provision ought to be made for considering changes in construction costs as well as for deducting the amount of depreciation from the time of the valuation to the time of the fire. Such a valued policy law would not be very objectionable.

Opposition of Insurance Companies.

Insurance companies have from the first opposed the "valued policy laws" as economically and socially unsound. This opposition has been general and not limited to specific forms. Their opposition and the reasons therefor have been concisely stated in the following resolution adopted at one of the annual meetings of the National Board of Fire Underwriters:

"The true function of property insurance is the replacement by cash indemnity, of property values destroyed by hazards insured against,

"The so-called 'Valued policy laws' substitutes for actual value the fictitious basis of a mere paper valuation, which is economically unsound,

"Such 'Valued policy laws' are temptations to arson, dishonest claims and fraudulent practices, which increase the waste by fire, making higher insurance rates necessary, and thereby adding another further unnecessary burden upon the insuring public,

"Such 'valued policy laws,' in operation, tend to discriminate against honest citizens in favor of the criminal and the dishonest,

"That 'valued policy laws' are contrary to public interest and subversive of the true basis of insurance indemnity."[1]

There is also the difficulty and expense of valuing small properties at the time insurance is placed. This is a condition which must be seriously considered. If a premium is small, valuation of the property at the time it is insured is not justified. Some mutual fire insurance companies do not appraise and inspect properties unless the insurance amounts to a very large sum.[2]

[1] Proceedings of the National Board of Fire Underwriters, Op. Cit., 1924, p. 55.

[2] Associated Factory Mutual Fire Insurance Companies, Op. Cit.

Nevertheless, care in selecting risks must be assured. Since the "valued policy" laws in most cases apply only to total losses of real property, no serious concern need be felt at present. The tendency is for fewer adjustments to be negotiated under them, and in some states they are disregarded entirely.

CHAPTER VI.

THE INSURED AND THE SERVICE OF ADJUSTMENT

The Human Factor in Adjustments

The problems of fire loss adjustment discussed so far have concerned the agencies of adjustment and the valuation of the property. Of equal importance, is the problem of reaching an agreement with the insured. In the last analysis, all of the adjustment problems are very closely related to the insured. There would be no point in discussing the machinery of adjustment except with reference to the insured. The same is true of valuation. The "valued policy laws" passed by many states were designed to protect the insured by giving him bargaining power. The insured also relies upon the courts to protect his interests. In the same way, the insurer has the protection of the laws and the courts. The insurer is usually a legal entity transacting its business through agents. An insurance company is more or less impersonal. Of course, the adjusters are individuals, but they are not acting for themselves. The case of the insured is somewhat different. While many policy-holders are large corporations, the great majority are small corporations, firms or individuals. The personal element is, therefore, much more important on the side of the insured.

The Insured and the Property.

The concepts "Indemnity" and "Insurable Interest," while legally defined, have never been quite satisfactorily explained. They are theoretical concepts, and it becomes a difficult problem to apply them in practice. These concepts are used to define the insured's relation to the property. "The cardinal principle underlying the law of fire insurance is what is known as the 'doctrine of indemnity', established out of regard to the public interest and

welfare."[1] The insured is to be reimbursed for the loss of some valuable thing through fire and is to receive no more and no less than he lost. But how is his loss to be measured? Clearly, indemnity to the insured is a subjective concept for which no absolute objective measure exists. The same is true of the doctrine of "insurable interest," which holds that no person should be allowed to insure property except that in which he has some pecuniary interest and then only to the extent of that interest. An insurable interest may accrue to an owner, mortgages, lessee, tenant, common carrier, prospective purchaser, executor or administrator, warehouseman, or pawn broker.[2] The nature and extent of the interest in the property is of vital concern to the public as well as to the insurer.

Human Behavior.

A study of the fire loss situation in the United States is essentially a study in human motivation and behavior. Seventy-five per cent of the total fire loss in this country is the result of fires that could have been prevented.[3] Whether this tremendous fire waste is due to gross carelessness, improper underwriting, competition among insurance companies, instability of property ownership, high degree of flux or change, climate, or outright fraud and arson, it has a definite bearing on the adjustment of losses and must be given consideration by adjusters. A man suffering a fire loss is a victim of circumstances, and, nine times out of ten he would rather not have had the fire. In adjusting his claim genuine sympathy and understanding are necessary. Of course, he will not act like a man being asked to buy a car; the circumstances are different. Great emotional excitement and strain have been aroused by the very unusual situation in which he is placed. He will tend to be very suspicious regarding any advances made toward him. An attitude of self-defense is natural and the adjuster must, by his action, manner and speech, prove beyond doubt that

[1] E. R. Hardy, History of Principles of Insurance, Lectures in Fire Insurance, Insurance Institute of Hartford, 1913-14, p.
[2] E. R. Hardy, Op. Cit., p.
[3] Bulletin, Grain Dealers National Mutual Fire Insurance Company, Indianapolis, Ind., 1929.

he will handle the adjustment in a capable, disinterested and just manner.

Dishonesty Increased by Fire Loss.

The effect of a fire on the morality of the insured is to cause him in many cases to become dishonest in the presentation of his claim, even if his business dealings have previously been above reproach. Such a complete reversal in a man's morality no doubt explains the lack of appreciation of the problems by the general public. There are many ways in which fraud may be perpetrated by the insured. Overstatement of the value of the property and the extent of the damage, mistatement as to the cause of the fire, and the inclusion of property not in the possession of the insured at the time of the fire are common methods of defrauding the companies. Other facts having a bearing on the insurance or the fire may not be disclosed. For example, a building may have been unsalable because of a flaw in the title. Out of date or second-hand merchandise may be included in the inventory as seasonable. It is difficult for the adjuster to detect fraud of this nature, especially if the fire has been so severe as to destroy all evidence. The insured may also attempt to collect for damage not caused by the fire such as the following:[1]

(1) Cracks in masonry due to settling; (2) worn out or worthless material; (3) Damages to merchandise while in transit; (4) Windstorm damage entered as loss from lightning; (5) Gas explosions that were not caused by a hostile fire.

It must not be concluded, however, that all men become dishonest when their property burns. A great many are fair and reasonable in settling a claim. These individuals have a tremendous desire to get started again and quickly. A fire serves as a motivating force to men with initiative. Thus, a fire is a vital factor in man's behavior. It may tempt him to dishonesty or it may stir him to renewed activity.

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[1] Prentiss B. Reed, The Phoenix Assurance Company, Ltd., New York, personal interview, January, 1929.

The Moral Hazard

Moral Hazard—In General.

It seems to be an established fact that the problem of moral hazard is serious enough in fire insurance at times to cause grave concern and is never to be completely overlooked. By "Moral Hazard" is meant the risk of having to pay claims which are fraudulently conceived in full or in part. The risk of having to pay claims in excess of "actual cash value" because of the optimism, errors or bargaining ability of the insured is not a "Moral Hazard" risk. It is difficult to determine the extent of fraud as a factor in contributing to the fire loss of the country. No doubt fraud is present in cases where it is not suspected. Again, suspicion only is not sufficient ground for contesting a claim, and, consequently, many losses are paid which the adjusters feel were fraudulent. Statistics are not available even for claims proved fraudulent, although they are kept by the National Board of Fire Underwriters and perhaps other fiire insurance agencies. An estimate of the proportion of claims believed to be of fraudulent origin has been secured from the reports of the committee on losses and adjustments of the New York Board of Fire Underwriters. During the period from 1918 to 1927 inclusive, this committee supervised the adjustment of 45,365 losses. During the same period 2,223 moral hazard reports were turned in, thus indicating that suspicious circumstances warranting further investigation were discovered in about 5% of the cases.[1]

An attempt has been made by the writer to get from the various fire marshals in the United States and Canada an expression of opinion as well as all the available facts. A questionnaire was sent to 43 state and provincial fire marshals in the United States and Canada and to 5 city fire marshals in the East. While replies were received from only half of them, the consensus of opinion was that the "moral hazard" is an important factor in every locality, its importance varying with location, kind of business and financial conditions. The answers to a question con-

[1] Reports of Committee on Losses and Adjustments, New York Board of Fire Underwriters, New York, 1919 to 1928 inclusive.

cerning the extent of arson show a great variety of opinion. Concrete facts were not given in all cases. The estimates of the proportion of fires that are due to arson and fraud are not uniform, some being based upon the number of fires in which evidence of fraud was found, while others were based upon the number convicted.

The estimates of the proportion of fires due to arson, incendiarism and fraud ranged from 1½% to 20% most of them falling between 2% and 5%. In answer to the question, "In what kinds of business are arson, incendiarism and fraud the most evident or serious?", a variety of answers was received. These answers have been tabulated with the following result:

Vacant Dwellings	1
Dwellings	3
Rural Residential	1
Mercantile Establishments	6
Dry Goods	1
Over-insurance	2
Did not answer question	9
	23

The Type of Business a Factor in Fire Loss.

While it is difficult to separate the various factors influencing fire loss, it seems quite evident that the nature of the business is an important consideration. Some types of business are more hazardous from a physical standpoint and others from a moral standpoint. The problem of measuring the variation in moral hazard for different types of business is complicated by the tendency of individuals of certain nationalities and characteristics to be attracted to certain lines and the tendency of certain types of business to seek a special kind of location or environment. It is not alone the type of business that determines moral hazard, but also the type of individual and the character of his ownership. Most important of all, seems to be the kind of ownership of the property involved. Business customs seem to decree that a given type of business shall be conducted in a certain manner, and so, the nature of the property interests are somewhat characteristic of trades or businesses. How firmly a certain individual has his

"roots" implanted in the property is often an important consideration in fire insurance.

Individuals whose only interest in the property they control is that of an agent or custodian are poor moral risks because they do not stand to lose and may have much to gain through a fire.[1] Dealers in merchandise on a commission basis, field purchasing agents of houses dealing in cotton, grain, cotton seed, etc., managers of cooperative stores or chain stores, warehousemen and wearing apparel contractors are all examples of this type of risk. The agent in all of these cases has in his custody property belonging to others, which either he, as agent, or the owner has insured. While those entrusted with the property of others are usually subjected to periodical audit, it is not always effective in preventing theft, especially when the same individual has in his possession property belonging to several owners or if also he is a dealer in the same merchandise in his own account. Thus North and South, East and West, this external moral hazard is always present whenever valuable personal property is held by custodians for the real owner.[2]

An example of dishonest practice is found in the City of New York where a system of contracting is quite prevalent in the garment trades. It is believed that goods in the hands of these contractors are very commonly stolen and that fires are then set to hide the evidences of theft.[3] This is done either with or without the connivance of the contractor. Many instances have been known in which the contractor has had no insurance himself, but, even if the contractor can obtain no insurance, he still has the incentive for a fire if he must account for the disappearance of the goods. An easy way is to claim that a fire has consumed them. Cases have occurred where several owners have submitted statements of merchandise placed in the hands of a single con-

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[1] Prentiss B. Reed, "The Moral Hazard of Custodians," The Ounce of Prevention, April, 1924, Hooper-Holmes Inspection Service, N.Y.

[2] Prentiss B. Reed, Op. Cit.

[3] Report of Committee on Losses and Adjustments, New York Board of Fire Underwriters, 1926.

tractor for manufacture which did not coincide with the evidence remaining after the fire.[1]

A serious moral hazard may be present even in certain types of business conducted by the owners of the property insured.[2] This is especially true of the seasonal trades and in trades which are especially risky. An example of the seasonal type, is theWoman's Hat and Millinery business. In the spring of 1926, the Committee on Losses and Adjustments of the New York Board of Fire Underwriters was confronted with a serious situation among this type of risks. The fires in Woman's Hat and Millinery risks became so frequent that a special investigation was undertaken. Forty cases were involved. The final conclusion was that there was no organized arson. The suggestion arising from frequent fires, however, was so impelling to those who sought relief from a difficult trade and financial situation that one fire followed another in rapid succession. Thus, trade conditions in a given industry are often responsible for an increase in fire losses in that industry. The fur trade is especially hazardous and at times very profitable. In this trade, especially among the less responsible dealers, there is a distinctly bad moral hazard atmosphere.[3] Being of a speculative nature, the fur trade attracts people from other businesses when times are good. Many of these recruits have neither the means nor the experience needed, and lack business morality. When reverses overtake them fires are numerous. A further illustration of the variation in moral hazard by types of business is furnished by the following very interesting comment taken from the Weekly Underwriter in February, 1921:

"At present the lines in which the moral hazard appear worst are waists, other than silk; gas and electric fixtures; shoes and leather. It was thought that furs would contribute heavy losses about now, but it appears that the fur market has become so totally demoralized that it is no longer considered profitable to burn. Lines in which the moral hazard is most marked are those now presenting to owners a possible

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[1] Ibid.

[2] Reports of the Committee on Losses and Adjustments, New York Board of Fire Underwriters, New York, 1919 to 1928, inclusive.

[3] Ibid.

question whether a fire loss adjustment would yield better returns than to sell in the market."[1]

The effect of changing business conditions is also shown by the above quotation.

Fire Waste and Business Conditions

The importance of the "Moral Hazard" and of carelessness as causes of fire loss have been stressed. Changes in business conditions aggravate the seriousness of these factors.

A recent survey of fire waste in the city of Boston has revealed a marked correlation between fire losses and business conditions.[2] It was shown that fire losses in the city of Boston responded to business conditions at nearly every major change. There were extraordinary peaks of fire losses immediately following the major declines in business conditions of 1903-04, 1908, 1910, 1920-21 and 1923.

Recent Increase in Fire Waste.

During the last fourteen years there has been an unprecedented increase in fire losses in the United States. This tremendous increase in the value of property annually destroyed by fire has been mentioned by underwriters at each succeeding annual meeting.[3] This steady increase has been due in large part to the increase in insurable values. The very close relation existing between the Annual Fire Loss and the National Wealth is evident from a study of the following table:

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[1] The Weekly Underwriter, New York, Vol. CIV. p. 294.

[2] The Mayor's Committee on Fire Insurance Rates with the assistance of The Albert Russel Erskine Bureau, Harvard University, Miller McClintock, Director, and The Field Engineering Department National Fire Protection Association, Horatio Bond, Engineer, A report on the Problem of Fire Waste and Insurance Rates in the City of Boston, Superintendent of Printing, City of Boston, Dec. 10, 1929, p. 123.

[3] Proceedings of the National Board of Fire Underwriters, New York, Presidential Addresses, 1916 to 1928, inclusive.

Relation Between Fire Loss and National Wealth

Year	National Wealth[1] (000,000 omitted)	Index on 1900 Base	Adjusted Fire Loss[2] (000 omitted)	Index on 1900 Base
1880	43,642	49	74,643	49
1890	65,037	73	108,993	71
1900	88,517	100	153,429	100
1912	186,299	210	201,938	132
1922	320,803	362	494,041	322

Of course, the steady increase in the national wealth is not the only factor causing an increase in fire losses, but it is a very important one, and accounts for the general trend. Short time fluctuations in the amount of fire loss are caused in part by changes in business conditions and in part by seasonal variations.[3]

The Influence of Price Changes.

During the period since the war, price changes have had a tremendous effect on fire loss figures. Fire loss adjustments are made on the basis of cost to reproduce or replace less depreciation. The following table illustrates the effect of price changes on fire loss statistics:

Year	[4] Annual Fire Loss in U.S. Thousands of Dollars	Index of Fire Losses on 1913 Base	[5] Index of Building Material Wholesale Prices	[6] Index of Wholesale Prices Yearly Average	[7] Yearly Avg. of Closing Prices of Industrial Stocks $ Per Share	[8] Number of Commercial Failures
1927	478,245	235	162.6	146.8	214.54	23,146
1926	560,548	276	173.4	151.0	165.70	21,773
1925	559,418	274	175.1	158.7	152.65	21,214
1924	549,062	270	175.1	149.7	115.08	20,615
1923	535,372	264	189.1	153.7	107.78	18,718
1922	506,541	249	168.4	148.8	98.58	23,676
1921	495,406	244	165.4	146.9	79.38	19,652
1920	447,886	220	264.1	226.2	107.21	8,881
1919	320,540	158	201.4	206.4	105.77	6,451
1918	353,878	174	172.0	194.3	80.98	9,982
1917	289,535	142	157.0	177.2	85.44	13,855
1916	258,377	127	20.3	126.8	99.14	16,993
1915	172,033	85	94.0	100.8	75.35	22,156
1914	221,439	108	92.0	98.1	58.08	18,280
1913	203,763	100	100.0	100.0	58.19	16,037

[1] The World Almanac, 1928, p. 295-296.
[2] Proceedings of the National Board of Fire Underwriters, New York, 1928, p. 156. (These figures have been adjusted by deducting conflagrations losses. See The Insurance Almanac, 1929, p. 1111).
[3] The Mayor's Committee, Op. Cit., p. 118.
[4] Proceedings of the National Board of Fire Underwriters, 1928, p. 156.
[5] U.S. Labor Bulletin, No. 440, p. 9.
[6] Statistical Abstract of the United States, 1928, p. 317.
[7] Statistical Abstract of the United States, 1928, p. 310.
[8] Statistical Abstract of the United States, 1928, p. 312.

From 1913 to 1920 inclusive there appears to be a marked connection between increases in the price level of building materials and increases in fire losses. The tremendous drop in construction costs in 1921, however, does not seem to have affected fire losses.[1] This may have been due to the counteracting influence of poor business conditions. The Committee on Losses and Adjustments of the New York Board of Fire Underwriters commented on the effect of rising building costs in its report for 1923. Increased cost of repairing and replacing must necessarily be reflected in the amount of fire losses. At the 1923 meeting of the National Board of Fire Underwriters, it was also stated that one of the causes of the heavy increase in loss payments for 1922 was the marked increase in building construction costs. This increase in the cost of repairing and rebuilding frequently being from 75% to 100% over the original cost.[2]

Business Profits and Fire Losses.

The year 1919 was looked upon as a profitable year in the fire insurance business. A substantial increase in insurable values resulted in a higher premium income, while, in spite of this increase in risks outstanding, the amount of fire loss decreased nearly 10%. The reasons for this decline in fire waste seem to be clear. "Moral and financial hazards were at a minimum because of the generally prosperous conditions that prevailed, and the difficulty, delay and excessive cost of replacing destroyed property undoubtedly inspired greater care to avoid fire."[3] Of course, the elimination of hazardous war work, which had contributed to the 1918 fire loss, was in part responsible for the good showing in 1919, but the high margin of profits on all business undertakings was the more potent factor.

While underwriters were still rejoicing over the reduction in fire loss for 1919, a warning was sounded respecting the probable

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[1] See table, p.

[2] Proceedings of the National Board of Fire Underwriters, New York, 1923, p. 39.

[3] Proceedings, the National Board of Fire Underwriters, New York, 1920, p. 32.

increase in losses should the prosperous conditions then obtaining meet with a sudden reverse in the future.[1] The "sudden reverse" came very shortly and influenced very greatly the fire loss for 1920. No doubt inflated prices were quite a factor, but so was the disorganization of business due to the depression. "The readjustment of business conditions appears to have prompted the practice of the adage that 'it is easier to burn out than sell out'."[2] The following table, taken from the annual report of the chief of the Fire Department of New York City gives some indication of the seriousness of the moral hazard when profits decline and business depression sets in:

	No. of Fires		Increase
	1920	1919	%
Clothing (Women's)	79	24	229
Foundries, Metal Works & Machine Shops	95	62	53
Shoe & Leather Goods	64	33	94
Cloaks & Suits	50	23	117
Clothing (Men's)	51	27	89
Woolen & Worsted Goods	23	5	360
Electric Supplies & Fixtures	27	10	170
Paper Boxes	21	5	320
Clothing (Children's)	28	12	133
Shirts	20	7	385
Furnishings (Women & Children)	23	7	229
Dry Goods	38	29	31
Drug Stores	30	21	43
Barber Shops	24	15	60
Tailors (Men's)	48	40	20
Billiard & Pool Parlors	13	6	117
Laundries	20	14	43
Furnishings (Men's)	11	6	83
Embroideries and Laces	5	1	400

The Depression of 1921.

The annual fire loss continued to mount in 1921 because of the demoralized condition of business and in spite of declining property values. A tabulation has been made by the author of certain fire loss data for the years 1919 and 1921 to see if any definite conclusions can be drawn regarding the effect of changing

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[1] Report of Committee on Statistics and Origin of Fires, Proceedings the National Board of Fire Underwriters, New York, 1920, p.

[2] Proceedings, the National Board of Fire Underwriters, New York, 1921, p. 154.

business conditions on fire losses.[1] The year 1919 was considered to be a profitable one although certain abnormalities existed. The year 1921 was considered a very poor one for business generally. During the eleven months for which complete data were obtained there were 3793 fires involving losses of $5,000 or over in 1921 as against 3189 for the same period in 1919 representing an increase of nearly 20%. The month of December was the only month showing a decrease. In the total fire losses, the percentage of increase was about the same and an increase resulted during every month except February and September.

The number of losses and the amount of loss in mercantile risks showed a more decided increase for 1921 over 1919 than was the case for all classes combined. The number of losses practically doubled while the amount of losses showed an increase of nearly 50%. The increase in the case of miscellaneous manufacturing risks was about 30% in number of fires and between 3% and 4% in amount of loss. It must also be noted that the losses for 1921 were adjusted on the basis of a lower price level than those in 1919. If an allowance is made for this fact, the results will show a still greater increase in the amount of fire loss in all the above groups of risks.

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[1] Table on next page. (Since this paragraph was written, the results of a survey of fire waste in the city of Boston have been published, which substantiate the fundamental conclusions herein presented. See The Mayor's Committee, Op. Cit., p. 123).

GENERAL CLASSIFICATION OF FIRE LOSSES IN THE UNITED STATES AMOUNTING TO $5,000 AND OVER REPORTED BY MONTHS IN THE WEEKLY UNDERWRITER[1]

	All Classes of Risks				Miscellaneous Mercantile Risks			
	Number		Amount of Loss 000 omitted		Number		Amount of Loss 000 omitted	
M'th	1919	1921	1919	1921	1919	1921	1919	1921
Jan.	305	444	23,161	34,049	31	61	598	2718
Feb.	250	263	20,390	18,372	11	29	365	1125
Mar.	279	305	15,052	22,578	9	26	152	754
Apr.	241	351	15,395	19,456	5	37	205	1258
May	210	257	13,333	14,747	9	22	672	1554
June	210	254	8,799	18,762	2	24	29	807
July	328	448	15,208	23,917	17	78	857	2202
Aug.	332	388	17,294	19,535	20	39	810	665
Sept.	267	335	17,820	14,973	14	24	1067	647
Oct.								
Nov.	328	351	18,713	18,891	32	34	1206	992
Dec.	439	397	22,633	23,367	57	31	3045	562
Total	3189	3793	188,437	228,647	207	405	9006	13284
	Miscellaneous Mfg. Risks				Incendiary Losses			
Jan.	27	25	3,826	2,565	6	16	834	1118
Feb.	16	16	668	736	2	9	145	596
Mar.	12	35	1,128	1,967	5	17	108	880
Apr.	13	24	587	1,302	6	15	97	986
May	13	22	324	724	9	13	182	414
June	10	20	175	462	5	14	65	2245
July	12	28	580	1,159	1	22	40	449
Aug.	9	25	1,202	1,658	9	15	427	1390
Sept.	23	24	2,071	1,169	16	8	530	445
Oct.								
Nov.	40	24	1,791	1,177	6	8	90	342
Dec.	38	35	2,204	2,137	2	12	362	799
Total	213	278	14,556	15,056	67	149	2880	9664

The effect of the disorganization in business in 1921 as compared with 1919 on the number and amount of incendiary fire losses is also quite striking. The number of such losses increased from 67 to 149, or over 100%, while the amount increased from $2,880,000 to $9,664,000 or nearly 200%. During the worst of the depression the increase in fire losses was very noticeable. In

[1] The Weekly Underwriter; Vol. C, pp. 156, 306, 502, 673 and 863; Vol. CI, pp. 21, 161, 350, 553, 837; Vol. CII, p. 23; Vol. CIV, pp. 210, 400, 573, 824, 997; Vol. CV, pp. 24, 231, 393, 635, 1069; and Vol. CVI, p. 31.

February of 1921, the committee on Losses and Adjustments of the New York Board of Fire Underwriters reported that it had been handling approximately $2,500,000 in losses per month for four consecutive months.[1] Losses continued to increase in 1922 and 1923, when business was recovering but was still uncertain.[2]

Business Failures and Fire Losses.

It is notable that during the period from 1920 to 1926 inclusive the number of business failures increased while the average amount of liabilities decreased indicating that a larger number of smaller concerns were failing.[3] It is among these smaller businesses where adverse conditions are more apt to result in an increased fire loss. In 1924 failures in the wearing apparel trade resulted in an especially bad moral hazard. The number of failures and the number of fires appeared to run together as is shown by the following table:

FAILURES IN APPAREL TRADE 1924[4]
NEW YORK CITY

Type of Business	Fire Claims	Failures
Cloaks and Suits	14	22
Dresses	10	32
Clothing	6	18
Job Dry Goods	3	6
Cotton Goods	14	14
Silks and Shirts	12	24
Binding, Hats and Caps	1	3
Export and Import	0	2
Retail	0	4
Totals	60	125

An analysis of the record cards kept for these 60 claimants and 125 failures reveals much interesting information. This analysis showed:

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[1] The Weekly Underwriter, New York, Vol. CIV. p. 294.

[2] The Mayor's Committee, Op. Cit., p. 123.

[3] See table, p.

[4] Report of Com. on Losses and Adjustments, N.Y. Board of Fire Underwriters, New York, 1925.

Comment	60 Fire Loss Claimants	125 Failures
Individual ownership	21	43
In business less than 3 years.....	19	45
Criticized Fire or Fire Record...	8	21
Liabilities Excessive.....	9	16
Slow payments.....	12	64
Unfavorable Trade Comment....	12	21
No Statement	27	61

In 1927 there were an unusual number of fires in furniture factories and retail furniture stores, and in shoe factories and retail shoe stores in New York City.[1] These facts again emphasize the effect of business conditions on the extent of fire loss.

The following summary may now be made: changes in the amount of fire loss in the United States are caused by changes in insurable values, changes in prices, changes in conditions from season to season and cyclical changes in business conditions. In 1928, the Committee on Losses and Adjustments of the New York Board of Fire Underwriters, in reporting a decrease of $20,949 in the amount of fire loss for the first seven months of 1928 as compared with 1927, gave as the causes:[2]

1. Hand-to-mouth buying, stocks of goods low, very little not salable.

2. Little incentive to have a fire although business has not been too brisk in some lines.

3. Good results of the fight against arson has become generally known throughout the country.

4. Easier now to get from under a bad situation through bankruptcy proceedings than a fire.

5. Has been more real underwriting.

6. Has been more care in loss adjustment.

The solution to the moral hazard problem depends in part upon the insurance companies and in part upon the public. The public generally has not yet been brought to realize the seriousness of the crime of arson. It is difficult to secure indictments, especially when insurance companies have been defrauded, and it becomes necessary to study the circumstances surrounding the

[1] Report of Committee on Losses and Adjustments, Op. Cit., 1928.
[2] Weekly Underwriter, New York, Vol. CXIX, No. 7, Aug. 18, 1928, p. 319.

property and the insured. The type of business, its location and the condition of the trade should be ascertained. Companies must continuously collect trade and financial data for all sections of the country so that adjusters may be supplied with the facts necessary not only to determine values correctly but also to determine possible motives for starting fires. A much closer watch should be kept upon credit ratings, especially in those trades and at those times in which conditions are known to be unfavorable. In a falling market, the adjusters should be equipped to reduce the losses to a point where they will result in the same losses to the claimants as would have resulted had there been no fires. At any rate, adjusters should be in a position to eliminate all profit from fires. A study of the books, records and statements of a business suffering a fire loss might indicate motives for fraud and aid the adjuster in properly judging the claimant. The National Board of Fire Underwriters is becoming increasingly active in gathering information to help adjusters. It also maintains an arson department with a corps of trained investigators to aid in running down incendiaries.

Procedure in Loss Adjustment[1]

The goal in every fire loss adjustment is a prompt and satisfactory settlement with the claimant for an amount that just indemnifies him for the loss he has sustained under the policy. Already in the present chapter, great emphasis has been placed upon the insured as a factor in the adjustment of losses. The behavior of the human being under varying circumstances has been considered. Next will be discussed the Adjuster's procedure in achieving a correct settlement by solving these problems.

General Procedure.

In adjusting a fire loss, the procedure followed is extremely important. The adjuster, if he would be successful, must avoid discussion of questions upon which there is likely to be a difference of opinion. He must avoid being placed on the defensive.

[1] The discussion in this section is based upon letters received from adjusters.

The adjuster will do well to secure an agreement as to procedure. It is often more important to place the business on an operating basis than to secure a check from the insurance company. If the claimant and the adjuster can agree in principle that complete indemnity will be obtained by a given procedure, half the difficulty of settlement will have been eliminated.

Usually the chief interest of the policyholder in a manufacturing plant, grain elevator, storage warehouse or other business fire loss is to lose as little time as possible. The adjuster should cooperate in minimizing the time lost. Replacement or repair of buildings, machinery and equipment need not be delayed until the cash value of the loss has been determined. If the insured and the adjuster are competent and willing to arrive at an accurate valuation of the loss, the procedure and principle to be followed in a given case may be outlined and agreed upon in advance with little difficulty. Determining the liability of the insurance company then becomes more a matter of detail and routine. The above procedure will bring the claimant back to normal mentally and physically, and, with his business in full swing again, his conception of the loss will be modified. The adjuster will be dealing with a normal man again and the chances of a correct settlement of the loss are increased.

The adjuster, regardless of the type of claimant he has to deal with, must first sell himself. He must convince the insured of his desire and ability to properly and effectively determine the measure of loss and damage. The successful adjustment of losses is, in the opinion of many based upon this particular feature. If the adjuster can convince the claimant of his intention to be fair he has overcome the greatest obstacle.

While special tactics seem to be unnecessary in bringing about a settlement with worthy claimants, this does not seem to be the case in dealing with claimants who are in one way or another tricky or dishonest. By "tactics" is meant adopting an attitude or following a procedure designed to counteract and discourage trading or dishonest practices of an assured. Every capable adjuster is a student of human nature. He is able to size up the claimant quickly and to decide promptly what tactics, if any, are

necessary to arrive at the proper settlement. Of course, the procedure cannot be fixed or be determined entirely in advance of all negotiation but must be varied during the course of the adjustment to meet new conditions, situations and emotional attitudes as they arise. The adjuster first goes over the case very minutely without committing himself on a single point and when he has the general facts well in hand he decides upon a general procedure to be followed. No two cases are exactly alike, and the details of the adjustment procedure must be decided upon as occasion arises and many times spontaneously. The adjuster must first know thoroughly what he is doing, be able to discuss any phase of the loss intelligently, and impress the claimant with his ability to handle any situation that may arise.

Claimants Classified.

According to the experience of various adjusters, policyholders suffering fire loss may be divided into classes, each class demanding or requiring an adjustment approach different from that of the others.[1] Strictly speaking, every claimant is in a class by himself and consequently a special procedure is necessary to bring about a settlement with him. However, because of the recurrence of certain characteristics in individuals suffering fire loss, a classification may be made which ought to be of service in indicating general types of claimants and also serve as a basis for a discussion of the tactics or procedure followed in fire loss adjustment. The procedure in a given case must of course be altered to suit individual conditions or needs.

There does not seem to be any general agreement as to types or classes of claimants met in adjusting fire losses. Some adjusters believe there are only two classes, the worthy and the unworthy, while others feel that there exists a multiplicity of classes, so varied as to tax the ingenuity of the most experienced adjusters. The classification seems to be a question of degree. How minutely it is to be carried out is a question which can best be answered by determining the purpose for which the classification is

[1] Obtained by correspondence and interview.

to be used. In the present paper, the purpose is to provide a scientific method of approach to the problem of applying the theory of loss adjustment to concrete cases. If the classification is too detailed it will resemble the report of a case study, which, while no doubt very valuable, would be too voluminous for the present purpose. On the other hand, if the classification is not extensive enough, the resulting discussion of tactics and procedure would lose its value for practical purposes. While a very general classification dividing claimants into (1) Worthy, (2) Shrewd and Tricky, and (3) Unworthy seem to be used by most adjusters, it has been deemed more profitable to subdivide each of these classes in turn so that the final classification contains nine types. Considering the difficulties involved in arriving at a perfect classification, it is inevitable that the following has many shortcomings:[1]

A. The Worthy Claimants.
   1. Those who are honest, sincere and intelligent.
   2. Those who are passive and inexperienced, unintelligent, or over honest.
   3. Those who are suspicious of adjusters and insurance companies and disillusioned regarding their methods.
   4. Those who are not properly insured.

B. The Shrewd and Tricky Claimants.
   1. Those who are unreasonable, egotistic and grasping.
   2. Those who attempt to gain an advantage by bargaining or trading—matching wits with the adjuster.

C. The Unworthy Claimants.
   1. Those who are suspected of fraud either before or after the fire but against whom sufficient evidence is not obtainable.
   2. Those who practice fraud in adjusting a loss resulting from an apparently honest fire.
   3. Those who are incendiaries or arsonists.

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[1] Adjusters at present classify claimants in reports to a central organization or bureau in New York City (most likely the National Board of Fire Underwriters) but these facts are not available except to member companies.

Procedure With Worthy Claimants.

It is a great satisfaction to an adjuster to encounter a claimant who is fair, and who is willing to submit his claim to verification in every detail and cooperate fully in a complete investigation of the origin, extent of loss and other circumstances of the fire. Some adjusters believe this class to be in the minority, while others are more optimistic. It seems to be more nearly the consensus of opinion among adjusters, however, that the honest and reasonable claimant is in the majority (one adjuster estimated 70%), and that the great majority of adjustments with claimants of this type are promptly and properly made. Theoretically the claim is to be settled on the basis of exact figures, determined in accordance with sound principles as discussed in previous chapters. This is possible only in those cases in which the insured knows or is willing to aid in scientifically determining the exact amount of his loss and is satisfied to receive it without bickering. The adjuster representing the companies must also be in complete accord with the settlement.

In dealing with the honest and sincere claimant who is capable and willing to discuss values in a scientific manner, a frank and open consideration of the facts and a full discussion of the amount of loss or damage sustained is advocated by many adjusters. Other adjusters, as stated above, enter a word of caution and claim that a discussion of values and indemnities at too early a point in the adjustment is an unnecessary hazard. Differences of opinion should be avoided at the outset. This ordinarily can be done by a frank discussion of the procedure by which indemnity is to be determined. Before any discussion of the amount of the loss or the value of any of the items is undertaken, agreement should be obtained regarding the procedure which will result in full and just indemnity.

Many times an honest but excessive claim is presented by a person who is not experienced in salvaging or repairing fire damaged property or is not familiar with the terms of his policy. A fire ordinarily occurs once in a lifetime, and it is only natural that the damage is exaggerated by the inexperienced and unintelligent individual. On the other hand salvage experts and exper-

ienced repairmen have very often worked miracles with fire, smoke and water damaged property. A great deal of the difficulty experienced in the adjustment of fire claims is due to the insured's ignorance of the terms of his policy. A person ordinarily will not make a contract involving any amount of money, without first submitting it to his attorney for consideration. He will, on the other hand, take out insurance in large sums and never look at the contract to see whether it is properly written or whether the coverage is proper and as desired. Any error in writing the insurance is usually never discovered until after a fire. Some claimants, usually suffering from an inferiority complex, are afraid to include all items for which they are justly entitled to be reimbursed or are backward about pressing for their rights under the policy.

The greatest amount of patience and kindness is necessary when dealing with this type of individual. Carelessness in handling the details of adjustment and in not obtaining all of the facts has resulted in underpayment as well as overpayment of losses. While overpayment of losses is to be guarded against, it is equally important that individuals who lack vigor or intelligence in presenting their claims are not underpaid.

"Where there is no question as to the sincerity or the origin of a claim an adjuster can do grave harm to his principles in underpaying an honest loss. Subject to its expressed limitations, an insurance policy is a contract of indemnity and should, insofar as is able, indemnify the assured for as much of the loss as is possible, not as little as possible. Much adverse legislation has been enacted by reason of some adjuster not having in mind the Golden Rule."[1]

There seems to be a widespread belief among many policyholders (and, as one adjuster stated, the apparently intelligent ones are no exception) that in the event of a fire loss it is necessary that trickery and chicanery be resorted to in the presentation of the claim and in negotiating the settlement with the adjuster in order that the real loss may be collected. Consequently, many claimants believe that an excessive claim must be made in order

[1] A. T. Persson, "Fire Insurance Adjusting," Journal of American Insurance, November, 1928, p. 5.

to secure a just settlement. The universality of this belief and practice may be illustrated by citing the opinion of the secretary of one of the largest adjustment organizations in the country that 90% of all claims presented are excessive by at least 25%.

A problem in education as well as adjustment is presented when claimants of this type are encountered. The adjuster's first task is to convince the claimant that he is both honest and capable. He must be careful to conduct his investigation in such an impartial manner that the amount determined to be due the policyholder will be satisfactory to him. Diplomacy is the adjusters' main asset. He must remove the impression that the insurance companies intend to beat the claimant. The special service that the adjuster can render a claimant of this class is to convert him to belief in the doctrine that underwriters and adjusters are beneficient and just in their dealings with property owners.

Adjusters in nearly all cases point out that a great deal of trouble in adjusting losses arises because of improper insurance of the property. The responsibility for proper coverage lies with the policyholder. He should understand his policy; although he usually depends upon his broker for advice. In a statement distributed to policyholders, the Grain Dealers National Mutual Fire Insurance Company of Indianapolis, Indiana, said:

"The history of the fire insurance business will show, we believe, more carelessness, indifference, and, we dare say, ignorance regarding the contract, than is to be found in any other business of equal importance. Take country elevators alone, and examine the defective, incomplete descriptions so frequently used; the amounts of insurance to the several items so out of proportion to the valuation; the several policies on the property being often differently conditioned contracts."

The adjuster has a difficult task, indeed, in settling a loss that has not been properly covered. If an innocent or unintentional error has been made, it is ordinarily overlooked. Insurance companies have paid losses on buildings not covered at all, where it was clear that the intention was to insure them. However, under ordinary circumstances, the claimant is the loser if he is not properly insured.

Procedure With Shrewd and Tricky Claimants.

In dealing with the unreasonable, grasping or stubborn claimant it is necessary to make a careful analysis of the facts and adopt the position that the company will pay only the actual amount of the loss. Some adjusters believe in making an offer considerably below the actual loss sustained and then compromising for an amount at or near the actual cash value. Such tactics are hazardous, however, in that they suggest the same procedure to the claimant and give rise to the unfavorable opinion of adjusters that they try to cut down all loss claims to a minimum. Bargaining and trading methods generally are unjustifiable in settling a loss and seldom have to be resorted to. An honest estimate of the loss and a clear statement of the insured's rights backed by firmness and the "absent treatment" when necessary ought to produce results. It is the duty of the adjuster to educate the claimant even though rather severe measures are at times necessary. As one adjuster put it, it is often his job to first adjust the assured, educate him as to a just claim, and then to arrive at the amount payable as equitably as possible.

With some individuals, trading is an inborn trait. Even though honest in other respects they cannot resist the temptation to "dicker" and try to gain some advantage from the adjuster. Often such persons have previously suffered a fire. Claimants of this class endeavor to get the greatest amount of money from the company regardless of the extent of the loss. They believe it is fair to take advantage of the adjuster or the companies and, if successful, feel they are thus rewarded for superior ability. This class of claimant is increased by the activities of public adjusters in some communities. In such cases, the adjuster must place the claimant on the defensive and prove to him that he is capable of handling any situation that may arise.

It is not possible to prove arson or fraud in all cases in which found. It may be quite evident to the adjuster that a given fire was intentionally set, or that fraud has been perpetrated following the fire, and yet he may not be able to prove it. The adjuster is often a man skilled in detecting crime but he also recognizes

that conclusive evidence is essential to secure a conviction or defeat a claim. It may even be detrimental to the interests of the companies he represents to push the investigation of such a claim. Unquestionably a large number of losses fall under this class. If the adjuster is satisfied the claim is fraudulent he is prepared to take advantage of every technicality in the policy and delay the payment of the claim as long as possible. If no legitimate proof that the claim is fraudulent is uncovered, adjusters feel justified in forcing a compromise settlement at as low a figure as possible or in forcing the claimant into court to collect. Tremendous responsibility rests upon the adjuster in such cases, and he must proceed with care, in order that his judgment may be sound and his decision just.

If the loss in question is an important one, it is the practice of stock companies to employ a special investigator. The National Board of Fire Underwriters cooperates in this respect.

"It is almost impossible to separate adjustment investigations from those connected with arson; and where there is insufficient evidence to justify a successful prosecution for arson, the special agents of the committee on adjustments devote their attention to reducing the loss. This is accomplished by careful analysis of business conditions, consulting Dun's reports, checking up bills, examination of books and bankruptcy proceedings, verification of various statements made by the assured, and other collateral matters....This careful scrutiny of adjustments has had a deterrent effect upon the assured who might be inclined to over-inflate his claim against the companies. The heavy over-payment of losses—formerly prevailing in such losses—has practically become non existent where our agents assist in settling claims."[1]

When the claimant realizes that the adjuster and the special investigator, are obtaining every available fact connected with the fire, he will show a willingness to settle for a reasonable amount. In many cases he is willing to dismiss the claim entirely and surrender his policies, especially if he realizes he is under suspicion and subject to criminal prosecution. If an agreement is not reached, the evidence collected by the adjuster and special in-

[1] Report of Committee on Adjustments, National Board of Fire Underwriters, 1925, p. 67.

vestigator will be of great value in a law suit. These data are also preserved for use in the event of a subsequent fire by the same claimant.

Procedure With Dishonest Claimants.

Even though the fire is an honest one as to origin, and the insured has a first class reputation, some peculiar situation in which he is placed, as a result of the fire, may lead him to dishonesty in collecting from the insurer a sum he knows to be in excess of the actual loss sustained. He may reason that the trouble and expense he has been put to in addition to the fire loss give him cause to do this, since, even with the overpayment to him, he is no better off than he would have been had there been no fire. Such fraud may take the form of passive failure to meet obligations or active steps to defraud the insurance companies. Instances have occurred in which inventory figures had been altered following a fire and others in which additional inventory sheets had been added.

The procedure in a case of fraud following an apparently honest fire is somewhat the same as that in which fraud or arson is suspected except that a more vigorous procedure is adopted. Local authorities are requested to cooperate, and every effort is made to gather sufficient evidence to defeat the claim entirely.

There does not exist a more insidious criminal than the one who has intentionally originated a fire for personal profit. His activities should be curbed by severe penalties. In dealing with him, the adjuster becomes a detective in search of evidence to convict. The cooperation of local authorities as well as special agents of the National Board of Fire Underwriters should be sought. All evidence which may be of value in a criminal as well as civil court case should be presented. However, the claim may be defeated even in the absence of evidence sufficient to secure conviction on a criminal charge.

The Service of Loss Adjustment

Services Rendered by Adjusters.

The procedure of the adjusters in dealing with the claimant is directly dependent upon the services they are able to render, and the final settlement is conditioned by the nature of these services. There is a very broad field for the adjusters with personality and ability to render real social service in the handling of fire loss claims. Experienced and successful adjusters are at present rendering this service. Their thorough knowledge of the insurance contract and their training in ascertaining values and depreciation as well as their keen and sympathetic understanding of the problems confronting the victim of a fire, make first class adjusters important assets to society. The various services which are from time to time rendered by adjusters in the settlement of fire loss claims may be summarized as follows:[1]

A. Prompt aid and advice following a fire.

1. An adjuster is placed on the case just as quickly as possible. In many cases the adjuster arrives within twenty-four hours. This is a decidedly important service since the policyholder is apt to be wrought up and need prompt aid and advice. Practically all adjusters urge speed in getting "on the job." Frequently the policyholder is interviewed by a company representative a few hours following a fire. Many opportunities for service are immediately discovered by the capable adjuster.

2. Instructions are dispatched at once, advising the insured to take active steps to protect the remaining undamaged property. As soon as the adjuster reaches the scene of the fire he cooperates with the insured in caring for the undamaged goods. The adjuster not only aids in preventing further damage to the property from exposure, fire, theft, etc., but also by making a careful check-up to see that the property remaining undamaged is fully protected by insurance.

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[1] Based upon letters received from adjusters and officials of insurance companies.

3. Instructions and advice as to the best way to salvage damaged property are given the assured by mail or through the adjuster. The adjuster then cooperates in the work of reconditioning and disposing of it to the best advantage. He is frequently able to assist in salvaging property not properly covered by insurance. This extra service is rendered free of charge. Of course, all salvage is handled for the account of whom it may concern until interests have been determined. It is essential that the adjuster employed be trained and experienced in rendering this important service, since the assured in most cases has never handled salvage.

B. Examination and analysis of policies.

1. The various policies of insurance covering the property are examined by the adjuster as soon as possible and the other companies interested in the risk are notified.

2. The various policies are analyzed and the policyholder instructed as to his rights and obligations under them. The various provisions in the contract are made clear to the assured, and the reasons for making certain interpretations are explained. The policyholder must be made to realize that a fire insurance policy is a two party contract, involving obligations of him as well as the company. If presented in a courteous and sympathetic manner, instructions as to just what steps are precedent to recovery from the insurance companies will be welcomed by the assured.

C. Prompt restoration of property.

1. The average honest individual is more interested in getting started again than in anything else. Adjusters often render an important service by taking immediate steps to repair or replace the buildings and equipment, so that the interruption of work caused by the fire may be reduced to a minimum.

2. If the assured contemplates rebuilding the benefit of the company's engineering service is offered with a view of pointing out construction features he should observe which will tend to reduce his fire hazard and his insurance rates.

D. Prompt and accurate settlement.

1. Assistance is rendered the assured in inventorying and appraising the amount of the loss.

2. Advantage is not taken of technicalities when "moral hazard" is not involved.

3. The advice of experts is sought by the adjuster to settle technical matters which come up during the course of the adjustment.

4. The adjuster is well qualified to prepare all the papers for signature of the assured. The services of an attorney are not necessary. Very few attorneys have a knowledge of insurance law. Much time and expense is saved by having the adjuster perform this service.

E. Prompt payment of loss.

1. When the amount of the loss has been agreed upon and the proof of loss has been signed, payment should be made at once without discount, unless the state law required a delay. Prompt payment enables the assured to continue business with the minimum loss of time.

2. If payment is to be made by replacement or repair, it should be effected at once.

F. Intangible services.

1. A friendly attitude is to be maintained throughout the period of adjustment.

2. The policyholder is shown that the adjuster and the company have a keen personal interest in his welfare.

3. By being courteous, patient and sympathetic the adjuster can offer many suggestions which are very beneficial to the assured.

4. Where possible the check is delivered personally and an endeavor is made to see that the assured is perfectly satisfied.

5. A fire insurance adjuster has a great opportunity for bettering the relations between the public and the insurance carrier by the method in which he handles his claims. The widespread lack of confidence in adjusters and underwriters can be counteracted.

6. Policyholders can be convinced that it is not necessary to resort to trickery, chicanery and dishonesty in presenting claims and collecting from companies.

The services above enumerated are not all rendered in any given case. They represent what has been done in various cases, and serve to illustrate the vast possibilities open to competent and enthusiastic adjusters. In what other business undertaking can similar opportunities to render real social service be found? Many of the services discussed above can be rendered to all policyholders whether suffering a fire loss or not. This is particularly true of any educational service. Furthermore, the task of the adjuster can be made more pleasant and fruitful by anticipating some of the difficulties that arise following a fire.

Services Rendered Prior to a Fire.

In discussing fire loss settlements, adjusters have repeatedly emphasized the importance of the relationship existing prior to a fire between the insurer and the insured. In view of this fact an attempt has been made to enumerate the various services that may be rendered at the time insurance is written and from that time to the time a fire actually occurs. It is safe to say that the difficulty of loss adjustment varies inversely with the amount of this service. The entire business of fire insurance is in its nature a true social service. The purpose of insurance is to see that the distress of the individual is not borne wholly by the individual himself but is shared by the many. In alleviating the distress of the individual, the insurance companies should not await the happening of the event insured against. It should undertake to prevent fires and to prepare the individual for the crisis if and when it comes. First and foremost among the services rendered prior to a fire, is the correct writing of the risk. The coverage, protecting the interests that the insured wishes covered, should be drawn up on the form and in such manner as to make an "air tight" adjustment possible. Some sort of a survey of the property at the time of placing the insurance seems essential. A prominent insurance company in the South writing many small risks writes, "Proper adjustment of losses doubtless is an im-

portant factor in the fire insurance business, and more especially so where mercantile stocks are taken into account. However, as to farm business the matter of adjustment becomes of less importance where there are correct underwriting practices... In this local company we have five directors in each county. For this reason the adjusters may learn more of the character of the insured than may an adjuster for a company located further from the risk. His information from our own directors is far more likely to be accurate than that secured by an adjuster from persons not interested in a company making an investigation. However the real advantage herein lies in the underwriting, in the placement of coverages."[1]

A further service that may be rendered is appraisal and repeated inspection of the property and consultation with the assured. Where drastic changes are thought to be necessary to reduce costs to the insured, expert engineering service may be supplied to supervise the work necessary for the adequate protection of the property. If steps are taken to acquaint the insured with the reduced cost of insurance which will result from the elimination of certain fire hazards, he will only be too willing to cooperate. Through a system of inspections prior to a loss, companies are enabled to see that the insurance is written concurrently and that the property is reasonably covered but not overinsured. Many complications are thereby avoided when a loss occurs.

Furthermore, it is the company's duty to instruct the insured as to his rights and duties under the policy. This should be done before as well as after a fire occurs. Correct underwriting demands a meeting of minds, and this has not been accomplished, if the insured does not understand his policy. The education of the policyholder is one of the most important services that can be given him. Even if personal inspection of the risk is not practical, contact with the policyholders can be effected by mail. Instructions relating to fire prevention and general care of the prop-

[1] Hurst, O. E., The Hurst Home Insurance Company, Lexington, Ky., letter July 4, 1929.

erty may be furnished, as well as instructions telling him what to do in the event of a fire. A very successful self-inspection system is used by a fire insurance company in the middle-west. Many advantages are claimed for it.[1]

In the first place, it calls for a knowledge of ordinary fire hazards on the part of those responsible for the care of the property. This is supplied by inspectors on their visits, and through a large poster containing "Self-Inspection Pointers" which is placed where it may be read frequently. In addition a double postal card is mailed once a month. One side contains a short talk on fire prevention, usually touching some seasonal hazard that should be watched. The other side contains a half dozen questions, the proper answering of which requires an inspection of the property. These questions may be answered and the card signed by the owner, manager or foreman; but the best results are obtained through having the inspection made by one who is not working in the property. The daily contact with a hazard is very likely to make one minimize its dangers. Therefore, the owner or manager is asked to interest himself in self-inspection, and make the receipt of the card the occasion for a personal inspection of the property. This monthly reminder that a fire might occur has the effect of making those who receive it more careful. The self-inspection system has no bearing on the policy contract. Whether the questions on the cards are answered right or wrong, makes no difference as far as the insurance is concerned. It is an honor system, and 98% of the men will do the right thing when it is put up to them in the right way. Opinions may honestly differ as to how the questions should be answered; but all that is waived. What is desired to get owners and employees into the habit of thinking that they have some responsibility for fire in their own property.

Where any owner, without good reason, refuses to adopt self-inspection the company is inclined to withhold the granting of insurance on his plant. A credit of 10% in the insurance cost is

[1] Pamphlet, Grain Dealers National Mutual Fire Insurance Company, Indianapolis, Ind.

granted for the completion and return of twelve consecutive cards. A proportionate credit is granted for the return of fewer than twelve cards. This makes quite a material saving in the insurance cost, and should be an incentive to enter whole-heartedly into the spirit of the system, regardless of other considerations.

A group of twenty-eight mutual companies operating in the "Associated Factory Mutual Fire Insurance Companies" offers the following services to all of its policyholders through an Inspection Department.[1]

1. Appraisals are made of all risks written to serve as a basis for proper underwriting.

2. Four inspections of all risks are made yearly by competent engineers. Complete reports of these inspections are made to members.

3. Plans of all risks insured are drawn and kept up to date. Copies of these plans are furnished members.

4. A staff of special engineers and experts is maintained to study the various problems of fire protection and fire prevention which arise in the plant already insured, and a study of all of the various features of construction, occupancy and exposure at plants which are contemplating taking out insurance.

5. Research is being conducted constantly along hundreds of different lines and services based on these studies are being rendered as opportunity affords.

Similar services are rendered by some brokers and by Associations of Stock Companies. Of course, service cannot be rendered without cost. Policyholders are willing to pay for service and companies would be justified in spending a larger proportion of the premiums received in the rendering of service prior to a fire. The amount of service that can be rendered each policyholder, however, is limited by the size of the premium collected. It is not advocated that companies should render all of the above services to each risk. Risks under $250,000 would not be given the complete service described above.

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[1] Headquarters are located at 184 High Street, Boston, Mass.

CHAPTER VII.

CONCLUSIONS

Reform in the methods of fire loss adjustment must be undertaken from the standpoint of (1) the insurer and available adjustment agencies, (2) the property and insurance coverage, (3) the insured and adjustment service. The various problems encountered under each of these heads are the natural results of customs, laws and business practices existing in the different sections of the country. These problems have changed in importance, and the attention given them has increased or decreased as the underlying conditions have become altered. The history of loss adjustments is one of continuous efforts on the part of insurance men to understand and solve these problems. That many problems still remain to be solved is to be expected, since changes in adjustment policy must be gradual. Drastic changes in adjustment methods are neither possible nor desirable. The fact that the outstanding leaders in the insurance field are devoting much of their time and attention to the adjustment situation is a hopeful sign.

The Insurer and Available Adjustment Agencies.

The fire loss adjustment machinery of the insurer has shown a tendency to change as business conditions and insurance practices in particular have changed. There has been a continued tendency from complete individualism toward complete cooperation in loss adjustment matters. While each insurance company has a certain individuality respecting the types of risks it accepts, there seems to be a need for a standardized and centrally controlled machinery to adjust the bulk of the losses, but especially to adjust losses from suspicious fires. This need has been brought about by the tremendous increase in the use of fire insurance by the mass of the people, which in turn has resulted in standardization in many directions. The machinery at present available for the ad-

justment of fire losses has serious defects which are responsible for a certain lack of uniformity in adjustment methods. A greater degree of cooperation on the part of the companies is desirable in order to coordinate the activities of the various adjustment agencies, at least by geographical sections, and to lessen the influence of brokers and local agents in the settlement of claims. Reform is especially necessary in the method of treating incendiary, dishonest, and suspicious claims. The automatic assignment of losses to regularly constituted adjustment agencies is an essential step in any plan of adjustment reform. A great deal of confidence and trust is placed in fire loss adjusters. Their qualifications should be of the highest. One of the most promising ways of improving the adjustment situation is by attracting and developing men for the work of loss adjustment. One of the aims of the National Board of Fire Underwriters is to raise the standard of the adjustment personnel. Public fire loss adjusters have become an essential part of the adjustment organization of the country. They render valuable services to claimants and insurance companies in the more congested districts. It seems advisable to continue the present policy of requiring them to be licensed. A higher standard of qualification, enforced by means of more thorough examinations, is necessary, however to gain for them a higher degree of public confidence.

The Property and Insurance Coverage.

The property at risk and the policy of insurance have both been greatly standardized in the United States. This standardization has been accomplished through fire prevention work and cooperation in the adoption of uniform policy provisions. The physical hazard, consequently has been greatly reduced and insurance protection made more certain. The extent to which this standardization can be carried is unknown, although in the case of some mutual companies it has been carried to the point where practically no physical fire hazard exists. However, the elimination of the physical hazard entirely can be accomplished only in the case of the larger risks, because the cost of fire prevention work must be paid out of the premiums collected. It is reasonable to

suppose that some physical hazard will exist for many years to come. The economic problems arising in fire loss adjustment can be solved by cooperation in the collection and dissemination of data regarding prices, business conditions, improvements in the arts, depreciation and style changes. Studies should be made of all factors affecting values, especial attention being given to obsolescence, local business conditions and local customs. Adjusters should be provided with such information continuously, since an exact knowledge of all facts is essential in appraising property damaged by fire. The human as well as the physical aspect of property values must be considered by adjusters. There are two major limitations to the value of a given property. The upper limit is its cost of reproduction and the lower limit is its power to produce an income for its owner. It is in fixing this lower limit that consideration of the human factor of the owner is so important. The fire insurance policy is becoming standard throughout the country. The application of policy provisions in the adjustment of losses is becoming easier as time goes on. Principles of valuation, as laid down by the various law courts, conform with those normally followed by adjusters and appraisers, but the chief uncertainty in connection with court decisions results from the inexperience of jurors valuing property. The valued policy laws are held by many to be contrary to the principle of indemnity. But there have been no serious developments accruing from their operation. The chief objection to them is the cost of inspecting small risks, which is out of line with the premiums. At present very few adjustments are influenced. The problem of valuation is not as difficult as it used to be. Adjusters are becoming more specialized, and experts in almost every field of endeavor and now available to them.

The Insured and the Service of Fire Loss Adjustment.

One of the distinctly American characteristics of the fire insurance business in the United States is the insurance of the person rather than the property. The great emphasis that has been placed on fire prevention in recent years has been due to this fact.

In certain European countries, the property rather than the person is insured .While it is not advocated that the fundamental assumption underlying fire insurance in this country be changed, it is believed that the greatest opportunity for improvement of the adjustment situation lies in the standardization of the insured. The improvement and control of the risk by reducing the personal hazard is a policy as promising as that of fire prevention and policy standardization one or two decades ago. The behavior of the claimant is a very important factor in loss adjustment. In many cases he must be taught his rights and obligations and also the principles of valuation. In some cases his attitude toward insurance and insurance companies must be changed. A thoroughly satisfactory settlement of a fire loss claim results only if the policyholder is satisfied. There are many ways in which service can be rendered the claimant and the rendering of service is an important part of indemnity.

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Questionnaires:

Adjusters:

C. X. Arnold, Los Angeles, Calif.
W. B. Barry, San Francisco, Calif.
H. D. Richardson, New Orleans, La.
Sam. H. Cromwell, Chattanooga, Tenn.
Guy H. Fuller, Oklahoma City, Okl.
Theo. F. Grefe, Des Moines, Iowa.
New Orleans Adj. Co., New Orleans, La.
W. L. Thomas, Phoenix, Ariz.
Aubner Smith, Paducah, Ky.
Charles F. Wilson, Denver, Colo.

Adjustment Bureaus:

W. P. Barry, San Francisco, Calif., Pac. Coast.
George Harrington, New York, N. Y. Comm.
J. C. Harding, Chicago, Ill., W. Adj. & I. Co.
E. P. Roberts, Atlanta, Ga., So. Adj. Bureau.
W. H. Gibbons, San Francisco, Calif., Pacific Coast Adj. Bureau.
G. H. Fuller, Okl. City, Okl., Fuller Adj. Co.

Fire Marshals of Following States and Provinces:

Alberta, Hawaii, Illinois, Kansas, Kentucky, Maine, Maryland, Massachusetts, Nebraska, New Brunswick, New Hampshire, New York City, North Carolina, Nova Scotia, Ohio, Ontario, Oregon, Pennsylvania, Philadelphia, Prince Edward Island, Saskatchewan, Vermont, West Virginia.

Mutual Insurance Companies:

Replies received from thirty-six companies in all parts of the United States.

Superintendents and Commissioners of Insurance of the following States and Provinces:

Alabama, Alaska, Alberta, Arizona, Arkansas, California, Canada, Colorado, Dist. of Columbia, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisana, Maine, Manitoba, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Brunswick, Newfoundland, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Nova Scotia, Ohio, Oklahoma, Ontario, Oregon, Pennsylvania, Prince Edward Island, Quebec, Rhode Island, Saskatchewan, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin.

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